A MICRO-FINANCE MODEL FOR RURAL INDIA*

Dr. N K Thingalaya**

Micro-finance has rightly gained the support of financial institutions, policy-makers and NGOs, the world over, as an effective means for ameliorating the living conditions of poor. Many experiments have been made in different countries to reach out to the have-nots and to extend credit support to them. However, the poorest segments of the rural economy still remain outside their reach. They have certainly a long way to go to attain the desirable goal of reaching them and elevating their living conditions. It requires the combined efforts of a number of agencies to help them by holding their hands and escorting them on the exalted road to self-reliance. Hurdles on the road are too many. But they are not insurmountable, given the determination to reach out to them.

Self-Help Groups have emerged as a collective, informal agency for encouraging thrift and for obtaining micro-finance. Over 22.38 lakh SHGs are in existence in India as on March 2006, providing the basic grass root-level institutional support to over 2.4 crore households. Banks, supported by NABARD, and NGOs attracted by the scope available for empowering the poor, are behind the show. There is a proliferation of the number of members joining SHG movement. Time-bound targets are being fixed to expand their base. Mere quantitative expansion is not sufficient to lift them above the poverty line. After they are raised above that ubiquitous line with credit facilities, it is necessary to support them at least for some time, so that they do not slip down, back into the unhappy situation.

Considering the enormity of the work involved in reaching out to all the households, a multi-agency approach is inevitable. Besides banks, NGOs and microfinance institutions also have specific roles to play in this task. Microfinance institutions, sponsored by NGOs and others are expected to be active players in this field, operating in different areas depending upon their suitability and acceptability.

In this article, an attempt is made to project the regional rural banks, with certain modifications, as a suitable microfinance model for rural India. This is not to preclude the other agencies from operating in this field. In recognition of the ground work already made by the regional rural banks in different parts of the country, it is proposed that they may be utilized as a reliable and workable model of microfinance institution. Their widely spread out rural branch network is indeed an integral part of the ***rural financial infrastructure, which is under-utilized.*** They have been operating for over 3 decades now, having gained considerable expertise in rural banking. Constituting 31 percent of the rural branch network of the banking sector, they are handling about 21 percent of the rural banking business (Thingalaya 2005). Nearly 33 percent of the credit linked SHGs are in their fold. Their

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** Professor - Emeritus, Justice K. S. Hegde Institute of Management.

credentials are good, but their capabilities are not adequately utilised.

Regional rural banks can be moulded to emerge as effective participants in this simplified credit delivery process. The complacent under-performance of many of them should not deter the policy-makers from assigning them greater responsibilities. Though uncertainties loom large over their future, their utility and suitability as microfinance institutions cannot be underestimated.

Bankers and Microfinance:

Bankers in India have accepted the inevitability of extending microfinance through SHG-bank linkage as a cost-effective means of reaching out to the poor. As they are facing the challenge of minimising the menace of non-performing assets (NPAs), they are in search of lending avenues, where the probability of the emergence of NPA is very low. Though profit maximisation is their prime goal, operating in an economy like that of India, they cannot afford to ignore the rural economy. Directed lending is apparently becoming slowly an unwelcome guest at the bank counters. Yet they can ill-afford to shut their doors for 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 would be a reliable medium, where microfinance is involved.

Bankers realise that both pre and post lending efforts become hassle-free in lending small doses of credit to SHGs. While identification of credit needs and rationalisation of the same is done by the groups themselves, peer pressure works as the collateral substitute for ensuring loan recovery. In addition, lending to this sector gives the much-needed social recognition for banks in the rural sector. 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.

For alleviating poverty, availability of credit adequately, cheaply and timely has been considered as a crucial input in all the policy prescriptions in India. Institutional credit agencies are charged with the responsibility of ensuring the flow of bank credit, by suitably refining their credit delivery mechanism. Various steps taken in this direction could make only a small dent on this problem. The Differential Rate of Interest scheme, one of the earliest experiments in micro-credit has been a failure, though being in operation for over three decades. Introduced in the 70s, banks were directed to lend at least one percent of their total advances to the poor at an interest rate of 4 percent under this scheme. Being a target-oriented credit programme, it has failed to make any impact on the rural credit scenario. The credit flow under this programme was unbelievably low. According to the available data, these advances constituted hardly 0.07 percent of the total bank advances in 2004 as against the target of 1 percent (RBI 2004). ***There was neither funds constraint nor the dearth of needy poor. The missing link was an appropriate credit delivery mechanism and post-sanction escorting.***

Commenting on one of the earliest micro thrift and lending programmes introduced by one of the banks in India, the Report of the Internal Group to Examine Issues Relating to Rural Credit and Microfinance has made a passing reference to Pigmy Deposit scheme. (Khan, H R, 2005). It is said, "The experience of banks most of the time has been adverse, with cash leakage, frauds and accounting and reconciliation problems. Most of the banks have now closed such schemes after booking losses". The experience of Syndicate Bank, the innovator of this scheme, was somewhat different.

As early as in 1928, Syndicate Bank has introduced Pigmy Deposit Scheme, under which the Bank was collecting daily from the door steps of the people of very small means, an amount as little as Re.0.25 through the specially appointed collectors, who were paid commission for their collections. Loans, equivalent to twice the amount saved, were given to the savers, without any additional collateral. This scheme was very useful in helping a large number of people from the lower strata of the rural society to improve their living conditions. (Thingalaya1978). The scheme has been in operation for over 75 years. But the shortsighted attitude of the unionized labour and the too legalistic attitude of the legal system have crippled its performance in the recent years. The compulsion of absorbing the deposit collectors into the Bank and altering the operational terms of the scheme is bound to reduce its cost-effectiveness. Imitations made by other banks and cooperatives, diluting the terms and conditions have not been very successful. However, as the Report has rightly indicated, "There is need to learn from this experience and device adequate checks and balances and utilize IT tools to make any future initiatives less risky for banks". It is heartening to note that Syndicate Bank has a programme of reviving the Pigmy Deposit Scheme by computerising the field-level operations. It is reported that the Bank has plans to recruit new Pigmy deposit collection agents for augmenting the daily collections by reaching out to a larger number of small depositors.

Though, as a business model, extending microfinance to SHG has been accepted as a practical proposition, there is little evidence to show that the banks have incorporated micro-finance as an integral part of their business plans. *Ad hocism* continues to influence their interest in this area. Interactions with branch managers in general have revealed that most of them do not have a clear idea of the operations of SHGs. With the implementation of Financial Sector Reforms, there has been retardation in rural branch expansion. The waning away of bankers' interest in small advances is explicit in the declining share of small advances, while micro-finance is yet to catch up widely.

Rural Financial Infrastructure:

Regional rural banks are in rural banking business ***by design and not by compulsion***, unlike the commercial banks. Operating in over 500 districts, they have a network of 14,372 branches as on March 2006. Most of them are in existence for nearly a quarter century, operating in remote rural areas in different geographic regions. Designed as low cost rural credit agencies, they have been directed to lend only to the weaker sections of the rural society from their inception. Viability of their operations was never considered by the policy makers as the major issue. The Working Group, whose report has led to the formation of these banks, has prepared the ideological framework as follows: "One of the more important objectives of the rural banks would be to attempt ***effective coverage*** of small and marginal farmers, landless labourers, and rural artisans. The performance of these banks will be judged primarily by their success in ***coverage of such categories*** of borrowers towards meaningful productive activity and recovery of their advances rather ***than by the profit they make***" (emphasis added) (Government of India, 1975). Evidently regional rural banks are introduced into the rural sector as a credit agency to cater to small borrowers, the ***target groups*** as they are called.

These banks have built up a rural customer base having 4.09 crore deposit accounts. The total number of deposit accounts handled by them, including those canvassed outside the rural areas is 5.37 crore. The average amount of savings per account is around Rs.5300. Another revealing feature of their rural operations is that they have brought into the banking fold a large number of female customers as depositors. Deposits made by female depositors constitute 20 percent of the total deposits, while it is lower at 15.8 percent for the banking sector as a whole. It is also evident that these banks have been able to inculcate the saving habits among the poor, even in some of the most backward districts, where they operate.

The number of borrowing accounts handled by regional rural banks is 1.29 crore, which is equal to 21percent of the total number of borrowing accounts of the banking sector. **Over one-fifth of the bank borrowers in India, are served by the regional rural banks.** The number of rural borrowers, the direct beneficiaries, who are intended to be served by these banks, however, is not growing significantly in the recent years. Many of the banks do not publish the data on their customer base, as they were doing religiously in the past. Details of the rural financial infrastructure are given in Annexure 1.

The achievement of regional rural banks in promoting and extending credit to SHGs is quite significant. Out of the 22.38 lakh SHGs linked to banks as on March 2006, 33 percent are from the regional rural banks. Their share is 29 percent in the volume of micro credit extended by the banking sector (NABARD 2006). The only notable deficiency of their achievement is the wide regional disparities in their performance. This lacuna however cannot be entirely attributed to the working of these banks. Many states did not welcome them initially and many others did not care to provide them any support, when they were passing through very critical period. While no new regional rural banks could be promoted now, it should not be difficult for the existing banks to expand their branch network in certain districts. In fact there was an implicit embargo on their branch expansion, as they were not permitted to recruit additional staff for manning the new branches.

Among the 196 regional rural banks (the number has come down to 133 as on March 2006 through the process of mergers, not closures) which, could be classified into three groups, the good, the bad and the ugly, based on the data available for FY2005.

The **good banks** are those earning profits, whose number is 165 and the amount of profit is Rs.934 crore. And there are 104 banks having no accumulated losses.

The **bad banks**, numbering 31, are incurring losses amounting to Rs.177 crore. Complacent under performance is their bane.

The **ugly banks** are those, which have accumulated losses. Their number is 92. High ratio of NPA and low credit-deposit ratio is their hallmark.

It may be noted that all the banks are associated with the SHG movement, with varying degrees of success. While the banks in the last two categories require specific remedial measures for their rejuvenation, the first group of banks can be certainly considered as capable of taking up the task of extending micro credit more efficiently.

Suitability of regional rural banks:

Regional rural banks may be considered as one of the most suitable financial agencies for promoting and fostering SHGs as a conduit for extending microfinance in rural India. Rural banking being their core-competence, they could be the major players in this arena in the future banking scenario. Recognising their strategic position, it is desirable to make them the kingpin in the microfinance movement. The strategic advantages, which these banks possess, make them an ideal micro finance institution, as discussed below.

Ready-made Rural Service Base:

Regional rural banks already have a ready made rural base, designed for handling the credit delivery system, conducive for small lending. Having branches in remote rural areas, manned by rural-oriented personnel, they have better accessibility to the needy households than any other agency. They are familiar with the rural ethos. They are fairly well spread out in the southern states and in the BIMARU states. In the north-eastern states they are not found in a large number of districts. However, wherever they are in operation, they can be made as the most suitable agency for extending micro finance, with some operational changes.

Micro finance institutions (mFI), as is being conceived at present, cannot afford to have cost-effective grass root level service points. They would be operating from bigger towns and may not have permanent service providers in the rural set up. Even if they wish to create such facilities, it would be a costly proposition. The transaction cost for regional rural banks would be substantially lower than that of mFIs.

Regarding the supervision of mFIs, there is a debate going on about the need for setting up a suitable supervisory system acceptable to the regulator. As far as the regional rural banks are concerned, a supervisory mechanism is already in place. And they are being monitored by more than one agency.

Ready Access to Low cost funds:

These banks have easy access to low cost funds, mobilised through savings bank deposits from rural households. Performance of many of them in this field is remarkable. For example, Karnataka Vikas Grameena Bank in Karnataka has a total deposit of Rs.1917 crore as on March 2006, of which 46 percent are savings bank deposits (KVG Bank 2006). In Prathama Bank, which operates in Uttar Pradesh, the component of savings bank deposits goes up to 71 percent (Prathama Bank 2006). While these examples relate to excellent performers, the regional rural banks mobilise on an average about 25 to 35 percent of their deposits through savings bank accounts.

The NGOs, which propose to promote mFIs, are pleading for the permission to raise deposits as low cost funds. The regulator is not willing to grant this facility, partly because of the bitter experience of the operations of non-banking finance companies in the past. A plea is also being made by some mFIs to permit them to access external commercial borrowings. This proposal is yet to be favourably considered by the Government of India and the Reserve Bank of India. The total credit needs of the micro finance sector may not be very large. It may not be more than 5 percent of the total credit lent annually by the banking system. It should not be therefore difficult for the domestic banking sector to meet this requirement. Besides, the availability of refinance facilities from NABARD would enable them to extend the credit support easily.

Ready Rapport with Small Borrowers: Regional rural banks have been dealing with only small borrowers from the beginning. They were precluded from lending to activities other than those pertaining to the prescribed target groups. Out of the 1.29 crore of borrowing accounts handled by them, 1.07 crore or 83 percent are in the advances group of less than Rs.25,000.(This is the lowest group of borrowings as classified in the Reserve Bank of India publications (RBI 2003a).

One of the undesirable features of their credit management is the lethargy in funds utilisation. The extent of funds deployed as loans and advances varies widely among them, from 18 percent to 90 percent of their deposits, the average being 42 percent. If they can mobilise savings in even some of the most backward districts where they operate, they can as well find eligible borrowers, specially those who need micro credit. The failure in credit management was sought to be compensated by investing in government securities, the less risky avenue for funds deployment. This route, however, is not totally free from the probabilities of requiring provisions to be made for the depreciation of the value of investments. These investments can be diverted into extending micro credit, without running the risk of poor recoveries, given the proper direction.

Unlike the mFIs, regional rural banks do not suffer from funds constraints, to begin with. They only need re-orientation in funds management. They possess the necessary expertise to nurture the transformation of mature SHGs into micro Enterprises. This process would be beneficial to both the borrowers and the lenders.

There is a proposal to permit the mFIs to work as "banking corresponds" for facilitating the flow of micro finance from the banks to the needy borrowers. When regional rural banks themselves can perform the functions of mFI, there is no need for another intermediary to connect them to the borrowers.

Viability of Rural Operations -Dubious?

The viability of these banks has been considered doubtful for long. Huge losses incurred by many of them and the complacent under performance of most of them have lent credence to this belief. However, according to the latest data, the number of profit making regional rural banks has increased to 165 and the profit made by them is Rs.934 crore. It is very interesting to note that there has been considerable improvement in the financial viability of these banks. Number of banks free from the burden of accumulated losses has gone up to 104. Similarly, the volume of loss of the 31 loss making banks has come down to Rs.177 crore. The black sheep among them, like the eternal loss incurring state electricity boards, need a different treatment altogether.

With interest de-regulation, they have been improving their bottom lines, by enlarging simultaneously the credit deposit ratio. And if they can also charge the rates of interest, which the mFIs charge, they can increase their profits appreciably. Micro finance ideally should not result in a high interest burden to the borrowers.

Supporting Actions Needed:
In order to make the regional rural banks an ideal mFI to serve the rural population, some supportive measures are needed. The first prerequisite is to accept the utility of these banks as one of the effective means for delivering micro finance, setting at rest the uncertainties regarding their future. The recent decision of the Government of India permitting their selective state-level mergers - merging the banks sponsored by the same public sector bank is a step in the right direction, though partial. Eighty-four gramin banks sponsored by 13 public sector banks in 11 states have been merged to form bigger gramin banks since September 2005. Their number has come down from 196 to 133.

This is only a partial consolidation of selected gramin banks and the process in on. The perennial loss incurring gramin banks in many states are yet to be included in the consolidation programme. Since the banks having huge accumulated losses cannot be allowed to go into liquidation, the feasibility of merging them with other gramin banks or inviting the new generation banks to take over them, has to be examined carefully. Instead of taking *ad hoc* decisions, it would be desirable to prepare a road map for the consolidation of gramin banks. This move would certainly enhance the operational size of the gramin banks, contributing largely to their viability. Privatisation of some of the strong gramin banks, freeing them from the tyranny of many masters, would be a proposition worth considering.

Re-orienting Regional Rural Banks:
Their crucial role in the field of micro finance must be reiterated by the policy makers and the regulator. Regional rural banks have been lending to the weaker sections in a routine manner all along. ***Micro finance should not become one more column in their reporting format.*** There has been very little effort made to re-orient their lending programmes, assigning the importance due to micro finance programmes. No doubt, many of them have tried to reach out to the Self Help Groups of rural women, as reported in their annual reports with photos of some of the *beneficiaries* as they are called. But that is not sufficient.

From micro-credit, regional rural banks have already graduated into micro-finance institutions. Besides lending small doses of credit and encouraging thrift by collecting small deposits, many of them have started selling other financial products like insurance and mutual funds. Quite a few of the annual reports of these banks reveal the details relating to the efforts made by them through cross selling such products. For example, the annual report of Krishna Grameena Bank operating in the less developed districts in northern Karnataka, discloses, " Bank has taken a corporate agency of marketing SBI-Life Shakthi group insurance for SHGs, covering 2829 members with sum assured Rs.7.07 crore and the premium being Rs.0.11 crore"(KGB 2006). Gurgaon Gramin Bank reports that extending Bancassurance, it has booked an income of Rs.40 lakh during FY2006 (GGB2006). Since these banks are now permitted to sell mutual fund products, a beginning has already been made by some.

The staff of regional rural banks, numbering 65,599 has to be trained in handling micro finance, with conceptual clarity and understanding the operational intricacies. Target fixation has to be avoided. Covering all the households in the villages coming under their jurisdiction, over a ***reasonable time frame*** should be the goal. This has to be derived from the methodically formulated Service Area Credit Plans forming part of the District Credit Plans. They should be built into the branch business plans. Andhra Pradesh Grameena Vikas Bank, the biggest regional rural bank in Andhra Pradesh (business Rs.4000 crore) has set up a record of lending Rs.260 crore to 1.28 lakh SHGs and has drawn up plans for extending its smart card programme to all its branches. It has a programme of raising the total advances to SHGs to Rs.400 crore. (Business Line 2006).

Credit mapping for microfinance:
The Service Area Credit Planning exercise needs overhauling, redefining of its scope to include micro finance and to specify the role of regional rural banks. Unfortunately it has become an annual form filling ritual undertaken by the lead banks. It is necessary to incorporate SHG-financing as a part of the Service Area Credit Planning. The Lead District Manager should take the lead in assessing the credit needs of the poor and then draw plans for reaching out to them in a phased manner. He has to work in close association with the District Development Manager of NABARD, regional rural banks, district central cooperative banks and the local NGOs in identifying the areas, where the poor families require micro finance support. Just as the lead banks were assigned the role of identifying spatial gaps in the availability of banking facilities in the rural areas, they may be entrusted with the task of identifying the ***need*** for microfinance in the command area of each rural branch.

This exercise should not become another form-filling ritual, generating an enormous volume of data, giving bank-wise target allocations. ***Village-wise credit mapping for microfinance has to be prepared, with a long-term perspective.*** The Lead Bank Managers have to be trained for this purpose. Their offices should be strengthened with the personnel conversant with economic survey, credit assessment and data warehousing. Access to this data bank should be available to any bank and NGOs interested in selecting areas for their operations.

Assistance from NABARD:
NABARD has indeed played a major role in fostering one of the largest numbers of SHGs in India. Through refinance facilities and offering training facilities, it has laid the foundation for the development of micro finance. "A micro finance Revolution: Committed by Compassion; Driven by Passion" its website declares. It further discloses "More than 400 women join SHG movement in India every hour", certainly a creditable achievement. The mission ahead is credit linkage of 585000 new SHGs by 2007 with 60 percent of them from 13 priority underdeveloped states. It also envisages

facilitating mature SHGs to graduate from micro finance for consumption or production credit to micro Enterprises.

Its intentions in expanding the programme to cover all the households are clearly explained. But there is little evidence available in any published document to indicate that any systematic study has been undertaken for credit mapping micro finance needs on an all India basis. Instead of fixing macro-level targets, it would be desirable to aggregate the field-level aspirations articulated by the prospective members of SHGs and vetted through village-level credit planning exercise.

There is an imperative need for augmenting the capital base of regional rural banks. NABARD has already set up a Micro Finance Development Equity Fund. This fund may be used for expanding the capital base of regional rural banks. Strategically, it would be very appropriate for NABARD to become a direct stakeholder of these banks. The Government of India may pass on its share in the ownership of these banks to NABARD. As a major shareholder, it can play a more proactive role in moulding regional rural banks as an ideal micro Finance Institutions.

Summing Up:

Many innovations have been made in India during the last half a century projecting rural credit as a means for fostering rural development. They have met with varying degrees of success or failure. The Integrated Rural Development Programme, on which too much hope was pinned as a poverty alleviation programme, turned out to be nothing short of a disaster. Among others, undue reliance on target-achievement and subsidy disbursement, were the factors responsible for this debacle. Microfinance programme should avoid the targets and subsidies consciously. Given the necessary support and direction, regional rural banks can emerge as reliable microfinance institutions. It does not need any institutional innovation. It needs only a purposive utilisation of the under-utilised installed capacity of the existing rural financial infrastructure. In the process of promoting and supporting new mFIs, the homegrown grass root-level credit agency like the regional rural banks should not be ignored.

Annexure: 1

Rural Financial Infrastructure: March 2006	
Regional Rural Banks (number)	133
Size of Branch network (number)	14,433
Share in Rural Branches (percentage)	45
Deposits Mobilised (Rs.crore)	61,425
Share in Rural Deposits (percentage)	56
Credit Extended (Rs.crore)	32,559
Share in Rural Credit (percentage)	60
Share in SHG Promotion (percentage)	33
Share in SHG lending (percentage)	29

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RURAL BANKING: THE FINAL DESTINATION

The rural branches should not remain like the village ration shops, selling only the subsidized products to the selected groups, as the branches of the gramin banks have been doing all along. They should evolve themselves as the retail outlets of financial supermarkets, selling the fast moving products at competitive prices and also have a strong door-delivery wing for the special customers, the SHGs, through micro-finance.