An Overview of Rural Banking System

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Abstract: Present study focuses on the major impact of rural banking system on Indian economy. Government of India promoted Regional Rural Banks (RRBs) through the RRBs Act of 1975 to bridge the gap in the flow of credit to the rural poor. The RRBs have a special place in the multi agency approach adopted to provide agricultural and rural credit in India. These banks are state-sponsored, regionally-based and rural oriented. Besides the RRBs, commercial and co-operative banks have been catering to the credit requirements of the rural sector.

Keywords: rural banking, economy, rural credit, rural oriented and credit requirement.

INTODUCTION

Regional Rural Banks in India is mainly focused upon the agro sector. Regional rural banks in India penetrated every corner of the country and extended a helping hand in the growth process of the country. Capital share of RRBs being 50% by the central government, 15% by the state government and 35% by the scheduled bank.

The renewed emphasis on agricultural and rural development by the Government of India would lead to a growing demand for different types of financial services in the rural areas. The present structure of rural credit may not be able to cater to the same. RRBs would be called upon to play a greater role in providing such services due to their rural character and feel. RRBs have to take over a larger share of credit disbursements calling for much larger resource mobilization, as also greater efforts for their institutional Strengthening.

History and Significance of Rural Banking in India

With the nationalization of banks in 1969 & 1980, establishment of Regional Rural Banks in 1975 and National Bank for Agriculture and Rural Development in 1982 by the Government of India, the policies evolved by the RBI laid a strong foundation for establishing "Rural Banking System" The Government of India set up Regional Rural Banks (RRBs) on October 2, 1975. Initially, five RRBs were set up on October 2, 1975 which was sponsored by Syndicate Bank, State Bank of India, Punjab National Bank, United Commercial Bank and United Bank of India.

RRBs were originally conceived as low cost institutions having a rural ethos, local feel and pro poor focus. SBI has 30 Regional Rural Banks in India known as RRBs. The rural banks of SBI are spread in 13 states extending from Kashmir to Karnataka and Himachal Pradesh to North East. The total number of SBIs Regional Rural Banks in India branches is 2349 (16%). Till date in rural banking in India, there are 14,475 rural banks in the country of which 2126 (91%) are located in remote rural areas. Apart from SBI, there are other few banks which functions for the development of the rural areas in India:

NABARD

National Bank for Agriculture and Rural Development (NABARD) is a development bank in the sector of Regional Rural Banks in India. It provides and regulates credit and gives service for the promotion and development of rural sectors mainly agriculture, small scale industries, cottage and village industries, handicrafts. It also finance rural crafts and other allied rural economic activities to promote integrated rural development. It helps in securing rural prosperity and its connected matters.

Sindhanur Urban Souharda Co-operative Bank

Sindhanur Urban Souharda Co-operative Bank, popularly known as SUCO BANK is the first of its kind in rural banks of India. The impressive story of its inception is interesting and inspiring for all the youth of this country.

United Bank of India

United Bank of India (UBI) also plays an important role in regional rural banks. It has expanded its branch network in a big way to actively participate in the developmental of the rural and semi-urban areas in conformity with the objectives of nationalisation.

Syndicate Bank

Syndicate bank was firmly rooted in rural India as rural banking and have a clear vision of future India by understanding the grassroot realities. Its progress has been abreast of the phase of progressive banking in India especially in rural banks.

Development of Regional Rural Banks (RRBs) in India

RRBs started their development process on 2nd October 1975 with the formation of a single bank (Prathama Garmin Bank). When the reform process in the banking sector was initiated, RRBs were taken up for a close look. In 1969, 14 major commercial banks were nationalised and the objective, inter alia, was "to control the heights of economy". The nationalized banks thus became important instruments for advancement of rural banking in addition to cooperatives and State Bank of India. The next step to supplement the efforts of cooperatives and commercial banks was the establishment of Regional Rural Banks in 1975 in different states with equity participation from commercial banks, Central and State Governments.

By 1982, to consolidate the various arrangements made by the RBI to promote/ supervise institutions and channel credit to rural areas, NABARD was established. Though several efforts were made to increase the flow of institutional credit for agricultural and rural lending, there were mismatches in credit and production. The GoI in consultation with RBI and NABARD started the reform process through a comprehensive package for RRBs including cleansing their balance sheets and recapitalizing them. Extant lending restrictions were removed and space and variety available for investment of their surplus funds was expanded. Simultaneously, a number of human resource development and Organizational Development Initiatives (ODI) were taken up by NABARD with funding support of the Swiss Development Corporation (SDC) and with the tools of training and exposure visits, ODI, technology support, computerization and use of IT, system development, etc. for business development and productivity improvement. By end March 2005, there was a remarkable improvement in the financial performance of RRBs as compared to the position prevailing in 1994-95.

The number of banks reporting profits went up to 166 of the 196 RRBs. As on 31 March 2006, of the total 133 RRBs (post merger), 111 posted profits and 75 of these RRBs were sustainably viable organizations having no accumulated losses as also posting current profits. GoI initiated the process of structural consolidation of RRBs by amalgamating RRBs sponsored by the same bank within a State as per the recommendations of the Vyas Committee (2004). The amalgamated RRBs were expected to provide better customer service due to better infrastructure, computerization of branches, pooling of experienced work force, common publicity / marketing efforts, etc. and also derive the benefits of a large area of operation, enhanced credit exposure limits and more diverse banking activities. As a result of the amalgamation, the number of RRBs was reduced from 196 to 133 as on 31 March, 2006 and to 96 as on 30 April 2007. Thus, 59 under the amalgamation process, 145 RRBs have been amalgamated to form 45 new RRBs.

Issues Related to Regional Rural Banks (RRBs)

RRBs (also known as 'Gramin Banks') Were set up with the objective of catering to the rural segment. However, they were undone by shortsighted government policy, which failed to take cognizance of their specific needs. Financial liberalization has placed both RRBs and other commercial banks on the same platform. Similar treatment, in terms of regulations, capital adequacy norms, and other compliance requirements, has been meted out, overlooking the fact that rural banks face hurdles in terms of higher transaction costs and difficult credit deployment and loan recovery. Recently, the government has initiated moves to merge these banks with their sponsor banks; as a result their numbers have quickly dwindled. The roadmap for India's banking sector envisions the emergence of a clutch of mega banks, each the size of SBI, formed by the merger of existing banks, to be in place by 2009 when the doors will be thrown open to foreign competition. The absorption of RRBs can be viewed as the prelude to the main act.
Certain issues related to RRBs are as follows:

Recapitalization of RRBs with negative Net Worth

Recapitalization of RRBs with negative net worth has to be given a serious Consideration as it would facilitate their growth, provide lenders a level of comfort and enable their achieving standard capital adequacy ratios. As on March 2004, 98 RRBs were in need of Rs. 3,050 cr for making the net worth positive. The position, as on 31 March 2006, is that 40 RRBs would require Rs.1718 cr.

Widening network and Expanding coverage

As on 01 April 2007, RRBs were covering 535 districts. They may be directed to cover all unbanked areas in these districts, taking the village as a unit, either by opening a branch (wherever feasible) or through the BF / BC model in a time bound manner. As on 01 April 2007, 87 districts in the country were not covered by RRBs and their area of operation may be extended to cover these districts.

Computerisation

With a view to facilitate the seamless integration of RRBs with the main payment system, there is a need to provide computerisation support to them. Banks will be eligible for support from the Financial Inclusion Funds on a matching contribution of 50% in regard to districts other than tribal districts and 75% in case of branches located in tribal districts under the Tribal Sub Plan.

Strengthening Boards of Management

Further, now that RRBs are being merged and are becoming large size entities, it is necessary that their Boards of Management are strengthened and powers
delegated to them on policy and business operations, viz. introduction of new liability and credit products, investment decisions, improving market orientation in raising and deployment of resources, non-fund based business, career progression, transfer policy etc.

Tax Incentives

From 2006-07, RRBs are liable to pay income tax. To further strengthen the RRBs, profits transferred to reserves could be exempted from tax till they achieve standard capital adequacy ratios. Alternately, RRBs may be allowed tax concessions to the extent of 40% of their profits, as per provisions under Sec. 36 (1) (viii) of the Income Tax Act.

Performance of RRBs

District Coverage

RRBs covered 525 out of 605 districts as on 31 March 2006. After amalgamation, RRBs have become quite large covering most parts of the State in many cases. Assam Gramin Vikas Bank, an amalgamated RRB, covers 25 districts, the highest in the country, while five other amalgamated RRBs cover 10 or more districts each. However, 40 RRBs covered two districts and 16 RRBs covered a single district each in 2005-06. Increased coverage of districts by RRBs makes them an important segment of the Rural Financial Institutions (RFI) for financial inclusion.

Branch Network

The number of branches of RRBs increased to 14,494 as on 31 March 2006 from 13,920 branches as on 31 March 1989. The network of the 45 amalgamated RRBs (as on April 2007) was quite large and diverse varying from 85 to 680 branches. The Uttar Bihar KGB, an amalgamated RRB, has 680 branches, followed by Baroda Eastern UPGB with 539 branches. The branch network of stand-alone RRBs varied between 8 and 242 as on 31 March 2006.

Performance under "Doubling of Agriculture Credit": RRBs

More importantly, the performance of RRBs under GoI's initiative on doubling of agriculture credit in three years (from base year 2003-04) and greater coverage of small and marginal farmers, have been impressive. They disbursed agriculture loans of the order of Rs. 12,404 crore during 2004-05 registering a phenomenal annual growth of 64% against the targeted

30%. During 2005-06, agriculture credit flow stood at Rs. 15,223 crore with a growth of 23%. Thus, RRBs have achieved the target of doubling of agriculture credit in 2 years. RRBs financed 18.58 lakh new farmers in 2004-05 and another 17.03 lakh new farmers in 2005-06.

RRB's Potential Role in Financial Inclusion

Post-merger RRBs represent a powerful instrument for financial inclusion. Their outreach vis-à-vis other scheduled commercial banks particularly in regions and across population groups facing the brunt of financial exclusion is impressive, as observed from an analysis of Basic Statistical Returns of the RBI and indicated in the following paragraphs. With merger infusing the much needed financial strength in RRBs coupled with the local feel and familiarity they command, RRBs are in a unique position to play a decisive role in financial inclusion. In rural areas, RRBs account for a substantial 37% of total offices of all Scheduled commercial banks. In semi-urban areas, their share comes to 15%. It goes without saying that exclusion is more severe in rural areas.

Savings Mobilisation

At all India level, RRBs account for 12% of all deposit accounts of scheduled commercial banks and a meager 3.5% of deposit amount. However, in rural areas, RRBs share in deposit accounts is a significant 31% and that in deposit amount 19% This shows that the average deposit amount is lower in RRBs than other commercial banks, thereby implying RRBs' better reach to small depositors. Both deposit and credit data indicate that RRB branches in rural areas have performed better in relation to other scheduled commercial bank branches. However, RRBs' share comes down significantly when data for both rural and semi-urban areas are considered. This could be due to the fact that branches of other scheduled commercial banks located in semi-urban areas disburse considerable loans in rural areas also. This is significant from the point of view of financial inclusion as rural branches are closer and more active in extending outreach to remote and interior villages.

Conclusion

With the evolution of Rural Banking Policy by the RBI slowly, steadily systematically and in a planned manner, the commercial banks in India showed impressive performance. Banks may need to commit themselves to serve progressively all households in a village, initiate steps to establish Financial Literacy and Credit Counseling Centers, adopt Technology Applications, make timely and judicious use of Financial Inclusion Fund and Financial Technology Fund and voluntarily adopt Mutual Code of Conduct. In the process, the Government may consider creating enabling environment and building rural infrastructure to facilitate rural financial institutions to serve all the rural households by 2015.

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