Banking for Rural Development: Emerging Trends, Issues and Concerns

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India has a long history of banking development. However, the need for utilizing banks as an instrument for economic development in rural areas engaged the attention of the policy makers only after independence. The historic All India Rural Credit Survey of 1954, though considered cooperatives as the most appropriate institutions for rural finance, recommended the nationalization of Imperial Bank of India as State Bank of India with a mandate to open 400 rural branches and enter into rural finance. The nationalization of 14 major banks in 1969 is another landmark in the journey of Indian banking towards *rural banking* from *urban oriented class banking.* With the entry of Gramin Banks in 1975, the rural banking witnessed remarkable structural change in rural financial market. The massive branch expansion programs in unbanked rural and semi-urban areas implemented under the Lead Bank Scheme and establishment of Gramin Banks resulted in fundamental change in the landscape of Indian banking system in terms of coverage, credit dispersion and provision of the banking services in rural areas.

However, in spite of these remarkable progresses in the Indian banking, the rural India is today deprived of the benefit of the high growth trajectory India witnessed in the recent years. The agricultural sector, which is the backbone of the rural India, witnessed deceleration in its growth and in deep crisis. The growth rate in agriculture less than population growth rate is threatening self-sufficiency and food security achieved during the green revolution. While nearly seventy percent of the Indian population lives in rural areas, its contribution to GDP declined to 17 percent. India has the largest number of poor people in the world and 75 percent of them live in the rural India. The majority of these people are excluded from the opportunities and services provided by the banking sector. The absence of easy and affordable access to banking facilities is considered a major constraint for achieving inclusive and faster economic growth in rural areas. Even after nearly four decades of public

sector banking, the inability of the banking sector to contribute to the welfare of the rural people is indeed a major area of concern.

The questions would now arise: why in spite of nationalization of banks and four decades of the banking sector involvement in rural financing, the rural India is today in deep crisis? Whether the banking sector failed to develop appropriate delivery system for provision of banking services to drive rural sector to higher and inclusive growth path? Whether the banking policy flawed to build a workable, viable and sustainable inclusive rural financial system and if not, what should be the way forward? All these call for detailed research and deliberations on what went wrong. Against this backdrop, this paper focuses on critically evaluating the contribution of banking for rural development and identifying the emerging issues and concerns with a view to devise appropriate policies and strategies to enable the banking sector to become a driving force to achieve inclusive and faster high growth in rural India.

Lopsided Rural Banking Expansion

The 1961 census showed that more than 50 percent of the towns and almost none of the villages had bank branches. The focus of the banking policy immediately after nationalization of 14 major banks in 1969 was naturally on branch expansion in unbanked locations. No doubt, due to the RBI's rural oriented branch licensing policy thrust, India achieved significant progress in rural banking network during two decades. The number of bank branches had increased from 8,262 branches in 1969 to 63,358 branches in early 1990s. The rural bank branches increased from 1,833 to 35,396 during this period. The share of rural branches in total bank branches went up from 18 percent to 58 percent during the same period. Consequently, the bank penetration ratio measured in terms of population served by a bank branch fell significantly from 1,40,000 to just under 17,000 in rural areas.

However, this trend was reversed during 1990s. The financial sector reforms implemented in 1992 focused on building a vibrant and competitive banking system. In order the banks could compete globally, the emphasis was accorded to prudential regulations based on profitability as the prime criterion. Consequently, there was a paradigm shift in RBI branch licensing policy. The rural banking orientation has lost the priority. Expansion in rural branch network came to a grinding halt. The number of rural branches has, in fact, steadily declined from 35,389 in 1993 to 30,551 in 2007. The total number of bank

branches during this period has, however, increased from 61,169 to 71,839. The percentage of rural branch network in total branches declined from 58 percent to 42 percent. Mergers and swapping of rural branches, rather than expansion, became the norm.

It is interesting to note that during the period 2007-2010, additional 12,765 branches were opened, out of which only 1943 (15 percent) were in rural areas. Most of the new branches opened were in metropolitan areas. Consequently, the share of rural branch network further declined to 38 percent[1]. With financial liberalization, the new breed of private banks has dawned on the Indian banking scene. They are making a beeline to only metropolitan and urban centres. They do not have the slang of opening rural branches. The trend has been, thus, reversed to 1960s. Even in the case of Gramin Banks launched with the avowed objective of serving rural areas, the number of branches declined from 14731 in 1993 to 14607 in 2006.

Thus the most disturbing feature of the post-reform period is the reversal of the trend in rural branch expansion to reach out to the unreached. The existence of a bank branch provides proximity and easy access to banking facilities to rural people. It also enables the bank to reach out and meet the varied credit needs of rural people and thereby play developmental role more effectively. The viability of rural branches was not an issue as most of the rural branches were operating on profit. The issue of information asymmetry and adverse selection was merely exaggerated as unlike developed countries, where banks operate as whole sale financial intermediaries, banks in India operate as retail branch banking. The branch officials can easily acquire reasonably good knowledge of the area and clientele they serve. The imperativeness of existence of banking institution for delivery of financial services in rural areas adopted following bank nationalization under Lead-Bank Scheme has been completely abandoned in the present policy framework of branch expansion.

It is also important to note that the banking penetration of 17,000 per bank branch is far behind developed countries, where less than 5,000 populations have access to a bank branch. Even as per geographic penetration in terms of number of bank branches per 1,000 sq km, India has only 23 bank branches as against 65 bank branches in South Korea and 45 in UK (World Bank, 2005). It should be also noted that in India, at present, out of six lakh villages, where 70 percent of the people live, only 5 percent of them are having bank offices. It is indeed a sad commentary that even

[1] Data used are culled from Handbook of Statistics on Indian Economy, RBI, 2009-10

after four decade of banking development under the Lead Bank Scheme, about 95 percent of villages today does not have bank branches.

Extent of Coverage: Too Inadequate

The geographical penetration of the banking system is, no doubt, important, in the ultimate analysis, the extent of coverage of rural households for provision of banking services is more important for rural development. Prior to independence, informal sources were the main sources of financial services in rural areas. Money lenders, traders and rich landlords accounted for more than 75 percent of rural credit. Formal financial institutions provided less than 9 percent[2]. The share of the banking sector was less than one percent. After nationalization of banks, the share of number of rural households indebted to institutional sources increased steadily to 67 percent, out of which the share of the banking sector was almost 40 percent. During the green revolution, the banks have made remarkable progress in financing farm households for agricultural development. In fact, the banks have succeeded in replacing the money lenders in rural areas.

Unfortunately, whatever the social and economic impacts of nationalization was short-lived. After 1990, exactly the opposite started to happen. The share of rural households indebted to institutional sources in the total indebted households steadily declined from 67 percent to 41percent. The rural households indebted to non-institutional sources increased sharply (59 percent) indicating the return of the rural money lender[3]. The 2001 census data also shows that out of 13.83 crore rural households, only 4.16 crore rural households (30 percent) have access to banking services and 70 percent of rural households (9.66 crore) are yet to be touched by banking sector.

The findings of the NSSO surveys (59th NSS Round-2003) were quite perturbing in this regard. Out of total 14.89 crore rural households, 9.24crore (62 percent) have no access to banking facilities. Among the farm households, out of 8.93 crore households, only 4.34 crore (48.6 percent) were reported indebtedness. Nearly 4.59 crore farmer households (51.4 percent) in the country were excluded from any credit facility from any credit agencies - institutional or non-institutional. As regards access to banks, only 27 percent of total farm households were found indebted to banks and the balance 73 percent were outside the banking fold. Among different categories of farmer households, bank credit access deprivation was found the

[2] Institutional sources include cooperatives, government etc besides banks including Regional Rural Banks.

[3] Data from All India Rural Debt and investment Surveys, RBI.

highest among resource poor small and marginal farmers and landless agricultural laborers. The regional disparity in institutional credit access exclusion was also found very wide. The proportion of farm households excluded from institutional credit access was as high as 96 percent in North-eastern, 81 percent in Eastern and 78 percent in Central regions. About 68 percent of the financially excluded farm households in India belonged to these three regions.

The dismal performance of the banking system in demographic penetration is also reflected in the coverage of deposit and credit accounts in rural areas. The number of saving accounts works out to 26.2 per 100 persons and 38.8 per 100 adults in the year 2007. As against this in urban areas; it is 50.7 and 75.2 respectively. The disparity between the rural and urban is very wide. The scenario emerging in regard to credit account penetration is still more pathetic. Credit accounts per 100 persons work out to only 6.5 and for adults, 9.6. It shows that nearly 90 percent of the adult population in rural areas has no access to credit services from the banks[4].

From the above empirical analysis, it is evidently clear that in the relentless pursuit of profits in recent years, the banks have almost forgotten what their primary mandate was at the time of nationalization and reversed to their earlier stance of metropolitan and urban banking.

Flawed Experiments to Reach Out

Since nationalization of banks, several experiments were undertaken by the banking system to reach out to the poor and deprived section of the rural community. First and foremost was the emphasis on small loans at cheaper rates without insisting upon collateral. Prior to nationalization, very few big accounts dominated the advance portfolio of the banks. Immediately after nationalization, the banks were directed to promote small loans less than Rs.10,000 to meet the credit needs of weaker section of the rural people[5] The small loan limit was originally fixed at Rs. 10,000 per borrower. The definition of small loans was revised in 1983 and the limit was raised to Rs.25, 000 per borrower.

The RBI subjected the banks' performance assessment to the number of small loan accounts serviced by them. Following the RBI directive, small loan accounts started growing rapidly particularly in the rural branches. Their number swelled from around 10 lakh on the eve of bank nationalization to slightly more than six crore in 1992. Their share in the total loan accounts peaked at 95 percent. After the financial sector reforms,

[4] It should be noted that many account holders have multiple deposit/credit accounts. There are also dormant accounts. If they are excluded, the scenario emerging would be furthermore pathetic.

[5] The small loan limit was originally fixed at Rs. 10,000 per borrower. The definition of small loans was revised in 1983 and the limit was raised to Rs.25, 000 per borrower.

small loan accounts lost the support of the banking system on account of their profit motive. The decline, both in the number of accounts and in their share in the total borrowing accounts, was significant. In 2007, the total number of small loan accounts was 3.86 crore and its share in the total accounts was 41 percent.

The Differential Rate of Interest (DRI) Scheme was another experiment introduced in 1972 to reach out to the poor section of the society particularly in rural areas. This initiative was introduced as a part of poverty alleviation program. Under this scheme, the banks were directed to lend at least 0.5 percent of their total advances to the poor at a concessional rate of 4 percent; 5 percent below the bank rate, which was 9 percent at that time. This limit was raised to one percent of the total advances in 1978. It was stipulated that 33 percent (later raised to 40 percent) of the DRI advances should be granted to the borrowers belonging to scheduled castes and scheduled tribes. To ensure that the benefits of the scheme should reach mainly to the rural poor, the banks were directed that at least 66 percent of their advances under the scheme should be made in rural areas.

With the initial enthusiasm to achieve the targets due to political compulsion, the banks have made concerted efforts to undertake financing under the DRI scheme. In 1990, there were 3.74 crore borrowing accounts and the amount lent was Rs.607 crore, which constituted 0.74 percent of the total bank credit. Likewise other programs, DRI scheme also came to almost a standstill after financial liberalization. The number of accounts declined from 3.75 core in 1990 to 2.6 lakh in 2007. The amount lent now constitutes hardly 0.06 percent of the total bank credit. DRI scheme is another lesson in disaster of a well intended program to reach out to the poor in rural areas.

The priority sector prescription was another thrust area immediately after the nationalization of the banks. The targets were fixed for hitherto neglected priority sectors such as agriculture. The flow of banks credit for priority sector was quite impressive during 1970s and 1980s. The share of agricultural credit in total bank credit rose from less than one percent prior to nationalization to the targeted 18 percent during 1980s. Since reforms, however, it has started steadily declining. In 2005, it was around 11 percent. It is only recently, following the government directive of doubling agricultural credit, there was a revival of increased flow of credit to agriculture. This revival was mainly due to sharp increase in indirect

finance and the rise in the flow of credit to urban agriculture. Between 1990 and 2006, the share of agricultural credit supplied by urban and metropolitan bank branches increased from 14.9 percent to 37.6 percent; out of which metropolitan branches alone increased their share from 4 percent to 23.8 percent. As against this, the share of agricultural credit supplied by rural and semi-urban branches declined significantly from 85 percent in 1990 to 62.4 percent in 2006 (Ramakumar and Chavan, 2007).

The integrated Rural Development Program (IRDP) is another exemplar of flawed approach for financing rural development. IRDP aimed at providing financial assistance to the rural poor in the form of bank credit and subsidy to acquire productive assets or skills for gainful employment in rural areas. Initiated in 1978 as a pilot project, the IRDP was expanded to cover all rural blocks by 1980. It became the lynchpin of India's anti-poverty effort in the 1980s. During 1980s and early 1990s, the program has made good progress in implementation. The program benefited about 29 million rural households; out of which, nearly 50 percent were SCs/STs and 25 percent women. However, since then, the program witnessed a setback.

Independent evaluation studies carried out have brought out a number of weaknesses of the program and its marginal impact on alleviation of rural poverty. While evaluating the factors, which contributed to the poor performance of the IRDP, the Draft Approach Paper for the Tenth Five Year Plan (2002-2007) has also conceded that " the program suffer from numerous defects including especially sub-critical investment levels, unviable projects, lack of technological and institutional capabilities in designing and executing projects utilizing local resources and expertise; illiterate and unskilled beneficiaries with no experience in managing an enterprise, indifferent delivery of credit by banks (high transaction cost, complex procedure, corruption, one-time credit, poor recovery), overcrowding of lending in certain projects such as dairy, poor targeting and selection of non-poor, absence of linkages between different components of the IRDP, rising indebtedness and the scale of IRDP outstripped capacity of government and banks to absorb".

Recent Initiatives of Micro-credit

The RBI and NABARD have recently undertaken several initiatives towards developing self-help groups (SHGs) and micro finance as major planks of the strategy for delivering financial services to the weaker section of the rural society

in a sustainable manner. In April, 1996, the RBI announced the new policy and advised the banks to consider lending to the SHGs as a segment of priority sector advances and integrate it with the mainstream credit operations. The SHG-Bank linkage model thus became a major plank of the strategy for delivering financial services to the poor and weaker section in the rural areas.

The SHG-Bank linkage program has made good progress since its inception. As on March, 2010, 69.53 lakh SHGs have linked with banks and held savings deposit of Rs. 6198.71 crore. The total loan amount outstanding was Rs. 28038.28 crore. Over 75 percent of the SHGs linked with banks were found to be exclusive women SHGs; most of them were poor and assetless. Empirical studies undertaken have shown that self-help microcredit groups enabled poor and weaker section of the community to bank for their emergent financial needs and contributed significantly to improve their self-esteem, social empowerment and social cohesion among members besides providing opportunities to some members to engage in productive self-employment.

The challenge is, however, to cover all the poor and weaker section households estimated to be more than 6 crore and sustain the existing SHGs. The long term prospect and sustainability of SHG-Bank linkage depend on opportunities for their members to invest in income generating activities and empowerment of members through training to develop required skills and capability. The evaluation studies undertaken have brought out many operational shortcomings of SHGs, which threaten their sustainability. Loans were mainly granted for consumption purpose and not to raise income levels. Most of the SHGs lack requisite skills and managerial capacity to graduate them to undertake income generating micro-enterprises. Wherever such ventures undertaken, marketing of the products posed a problem. In the case of SHGs sponsored by the government, they were formed only for availing the benefit of subsidies. Another area of concern is the political interference; political parties consider SHGs as another vote bank and make all efforts to control them. There are no empirical evidences to show that self-help micro credit groups have succeeded in helping their members to come out of poverty. There is already lurching fear that the movement may face the same fate as many other failed well-intended development programs.

Micro Finance Institutions (MFIs) have recently mushroomed all over India for provision of micro-credit to poor. There are, at present, more than 1500 NGO-MFIs and 20 company MFIs operating in

the field of microfinance. They finance directly to members of joint liability groups against group guarantee. Though there was a rapid expansion in their business, their involvement has not been an unqualified success. Since profits are the sole consideration for most of the MFIs, they dumped loans on borrowers. There are no empirical evidences to prove that micro credit enabled borrowers to rise out of poverty. The performance of MFIs has also come under adverse criticism. Loans were granted mainly for emerging consumption needs and not for income generating activities. Exorbitant interest rates of 30 – 60 percent were charged. Consequently, poor people have fallen into the debt trap. Multiple lending, zero tolerance of repayment delays, coercive methods of recovery of loans, nightmare of raids by agents of MFIs, exclusive focus on profit and non-transparent way of functioning have become the operational norms. Most of them have become modern money lenders for "sucking the blood from the poor in the name of poverty alleviation". Thus, MFIs as an innovative model to provide easy and affordable access to credit to the rural poor for their economic empowerment remained a myth and not a reality.

Notwithstanding the shortcomings of microfinance operation, it should be noted that the Task Force set up by the NABARD on microfinance in 1998 estimated the total demand for micro credit at around Rs.2,00,000 crore. As against this, the flow of credit from banks, SHGs and MFIs to the weaker sections under various programs is now estimated to be less than Rs.10,000 crore. With such a wide demand and supply gap in micro-credit, innumerable income generating micro-enterprises remain unexploited in the rural areas and the impact of the recent initiatives in this regard is too little and too inadequate.

Financial inclusion is now become a new mantra for rural banking. Access to safe, easy and affordable financial services is considered essential to provide growth opportunities for the poor, vulnerable groups and disadvantaged section of the society. With the emphasis on inclusive growth, more attention is therefore given to financial inclusion. Recognizing the critical importance of financial inclusion, the Government and the RBI have initiated a number of measures to bring the financially excluded, underprivileged and weaker section of the society within the fold of the formal financial system. These measures include opening of no-frill accounts, introduction of General Purpose Credit Cards up to Rs.25000 for rural people, use of ICT solutions through

branchless banking models, use of Business Facilitators and Business Correspondents and financial and literacy counseling. The government has set a target of 73000 habitations with population in excess of 2000 for 100 percent financial inclusion by providing no-frill accounts by March, 2012. With the initial enthusiasm and political compulsions, the banks are making every effort to fulfill the target by opening no-frill accounts, most of which have already become dormant.

Since financial inclusion is still in the inception stage of implementation, it is too early to assess its impact. However, the magnitude of the financial exclusion problems and issues and challenges involved in widening and deepening financial inclusion are enormous. Even if 73000 habitations are brought under the net through financial inclusion, there would still be about 5 lakh habitations left uncovered. Barriers to access both on supply and demand side are several and require to be removed to achieve greater and faster financial inclusion. Considering the huge gap between the reality and heady rhetoric, the fear is that the financial inclusion will remain far from inclusive and may face the same fate of many other earlier well-meaning development initiatives.

Crisis in Rural Development

The question arises why in spite of four decades of the banking sector involvement in financing rural development, Rural India is today in deep crisis. The banking sector, no doubt, contributed significantly to trigger green revolution in financing agriculture, which enabled the country to overcome food crisis and achieve self-sufficiency in food. However, since the beginning of 1990s, these trends were reversed. The agricultural sector has lost its growth momentum and witnessed deceleration in its growth. It declined from 3.2 per cent per annum in the earlier four decades to 1.5 per cent per annum during the last fifteen years. Food production remained more or less stagnant fluctuating between 210 and 230 million tons. With the population increase, the per capita food availability declined significantly below the 1950s level and thereby endangering the food security of the nation. Shortages of essential agricultural commodities have become more chronic and contributed recently towards overheating of the economy and led the country to food importing era.

While the share of agriculture in the total GDP declined to 15 percent, the percentage of population depending on agriculture for their livelihood remained

unchanged. In absolute terms, people directly or indirectly depending on agriculture in rural areas increased from 290 million in 1951 to 750 million now. The high growth trajectory in other sectors and the sharp deceleration in agricultural sector are widening rural-urban disparities in income. The employment growth rate in rural areas declined from 1.38 percent during 1980s to 0.18 percent during 1990s. More than 300 million people in rural areas are living below poverty line.

Agricultural policy and public investment triggered progress in agriculture earlier. At present, agricultural policy failed miserably. In fact, there is no agricultural policy now. Another major area of concern is the decline in the investment, both public and private in rural areas. The rate of investment in rural sector as a whole declined sharply from 7.07 percent of GDP in 1980s to 1.39 percent during 1990s. In absence of investment both public and private, the diversification of agriculture to high value added products, value addition through agro-processing to increase income of farmers and development of non-farm enterprises to supplement income of the rural people have not taken place. The farmers today are in the process of marginalization and pauperization.

Even after sixty years of planning and development, Indian agriculture is plagued with the problems of dependence on monsoon, low productivity, high cost paid out inputs, volatility of output prices, market uncertainties, mounting indebtedness, low value addition and poor rural infrastructure. Though, in every budget, large amounts are being earmarked and spent on various agricultural related programs, much of these seem to evaporate into thin air. Similarly huge sums are spent on irrigation or creating irrigation potential; but the actual area irrigated remained unchanged. Enormous amounts have been paid to fertilizers industry; but the crop yields remain very low; one of the lowest in the world. The same is the case with the bank credit for rural development. The credit disbursement in absolute terms has been rising; but without any economic impact. Agricultural credit played a positive role in green revolution; but not now. It only pushed farmers into debt, leading to distress and even suicides in some cases.

In the history of the country, though distress due to drought and crop failure was common, farmers' suicides were virtually unknown. According to official statistics, more than one lakh suicides by farmers were reported during the last five years. It is really pity that in the midst of growing prosperity, we have

agrarian distress symbolized by farmer suicides. A recent NSSO survey reveals that nearly 40 percent of farmers would like to quit farming given a choice. The tragedy is that the policy makers all along have been talking about rural development; the need to double the growth rate of agriculture, improve farmer's income, wipe out poverty in rural India and so on; but all are political rhetoric; concrete action has been missing.

India is blessed with diverse agro-ecological conditions and potential to grow variety of agricultural commodities and enterprising farming community. The green revolution proved the potential and dynamism of the agricultural sector. However, to achieve high growth, the rural sector should not merely depend on agricultural sector. It should also develop off-farm rural industrial and service activities to provide employment and raise income of rural people. Non-farm enterprising activities would trigger growth impulses in agriculture and other sectors in rural areas through backward and forward production and consumption linkages. Instead of continuing as a parking lot to poor people, the rural sector should become a place for lucrative returns and ample employment opportunities. The lessons from Chinese model of Townships and Village Enterprises (TVEs) are quite revealing in this regard. TVEs have been proved as one of the fastest sources of growth in China.

The road map to drive rural sector to high growth trajectory should not be merely agriculture-centric, but also focus on integrated development of non-farm sectors in rural areas. This requires a right package of policies and the smooth flow of private investment in rural areas not only in agriculture but also in off-farm income generating industrial and service sector activities. Access to safe, easy and affordable financial services to rural people would enable the rural people to diversify agriculture, undertake various income generating non-farm enterprise activities and thereby, take advantage of growth opportunities. Contrary to this, the rural India today is starved of private investments and credit to drive the rural economy in this direction. The banking sector has, thus a crucial role to play in this direction. The question is whether our banking sector is prepared and geared to accept this challenge.

Rural Banking at Cross Roads

Rural banking in India is today at the cross roads. The strategies adopted in the past were mainly centered on supply side by compulsion; expansion of bank network under Lead Bank Scheme and targeted credit to specified sectors. There

was hardly any policy focus on demand side to meet the varied financial needs of rural households. If the majority of rural households are still not covered by the banks, it is because their products do not pass the test of appropriateness of rural areas: relevance, convenience, reliability, flexibility and continuity. The financial sector reforms and prudential regulations during 1990s changed the landscape of financial services from social banking to class and profitable banking. The focus of the financial sector reform is more on creating a strong and globally competitive banking system. In pursuance of this goal, the banks are retreating from rural areas. The banks no longer consider 750 million rural people in bottom of the pyramid as business opportunities for banking. The Gramin Banks, which were set up solely with rural orientation, have not been given a fair deal under the Financial Sector Reforms. It is really unfortunate that instead of addressing the problem of rural banking, all measures adopted under Financial Sector Reforms reversed whatever achievement made in rural banking and brought back the money lender to the fore.

The following emerging trends in Indian banking are also really disturbing and have far reaching implications for future of rural banking:

- **Retreat of banks in rural branch expansion**: During the last two decades, there is hardly any expansion in the rural bank branch network. Whatever few branches opened in rural areas were mostly by Gramin Banks. Even Gramin Banks are also slow in opening branches in unbanked rural areas. Under financial inclusion, the emphasis is not on a brick-and-mortar facility, but on use of ICT and Business Correspondent model for rural banking. Whether the branchless banking through BCs is the real solution for rural banking, whether it can be used for meeting varied credit needs of the rural people and whether it can be sustained in long term are doubtful.

- **Declining trend in Rural Credit/ Deposit Ratio**: Rural credit/deposit ratio has declined significantly in recent years. It declined from 65 percent in 1991 to 45 percent in 2007. On the other hand, the rural deposit as proportion of the total deposit has gone up from 3 percent to 20 percent. As against this, the rural credit constitutes less than 50 percent of the rural deposits, which clearly shows that the banks are more interested in mobilizing rural saving rather than providing credit for rural development.

- **Dilution in the scope of priority sectors advances**: The definition and scope of priority sector advances have been diluted in favor of urban oriented

advances such as retail, housing, consumer, venture capital, software loans etc. Consequently, direct lending to farmers and the weaker sections is no more remained priority focus to the banks.

- **Enlarged presence of foreign banks and new breed private banks**: Under WTO Agreement, India has no choice but to allow foreign banks free entry on reciprocal basis. Private sector is also entering the banking business. Whether they will be interested in financing rural banking is doubtful.

- **Micro finance in waning phase**: The SHG movement and MFIs are considered as appropriate intermediaries for financing the poor and weaker section of the rural community. Their operational features are much to be desired and their sustainability in the long term perspective is doubtful.

The thrust of the financial inclusion is on opening of no-frills accounts and use of ICT solution for delivery of financial services. Building the institutional capacity for expanding the outreach of the banks in rural areas was completely ignored. Instead of brick and mortar banking facility, the emphasis is now accorded on use of ICT enabled branchless banking through business correspondents. The opening a no-frill account is not what the Rural India required. What the Rural India need is access to not only for saving but also for meeting the growing credit and other financial service needs for their economic and social empowerment. This cannot be achieved by listing them overnight as account-holders; either through no frills accounts or through small doses of credit in one-go through business correspondents. This has to be done by building an inclusive rural financial system capable of undertaking on planned basis the varied financial service needs of rural development. Whether the out-sourced branchless banking can substitute the traditional 'brick-and-mortar' bank branches to undertake banking services for rural development is a question of serious concern. Though, it holds out great promise in reaching out, it should not e seen as a stand-alone magic bullet.

The present enthusiasm of the banking system driven by political compulsion to reach out to the un-reached should not result in increasing the dormant savings bank accounts after the initial drive vanishes; nor should the easy access to institutional credit result in the borrowers bearing the debt-burden involuntarily. The empirical studies have evidently shown that there are many complex reasons why rural people do not seek more access to formal financial services. It is not the lack of demand. In most of the cases, there is

a latent demand and only innovative, easy and affordable cost of financial services can bring them out. In other cases, demand cannot be satisfied by the financial products or delivery methodologies currently being offered by the banks. The rural households want financial services that match their needs to improve their livelihood. Their requirements are real and practical: convenient, affordable, flexible, continuously available and reliable. What is required is that the banks should "look through the eyes of their customers" at grass root level and provide what they want. Seeing the out-sourced branchless banking as a solution, which the professional banker failed to do in the past, can be a potential disaster.

Strategic Interventions Needed

Against these worrisome emerging trends in both rural sector and banking, the question would arise: what should be the strategies required for development of appropriate inclusive rural banking system which can drive the rural sector to faster, higher and inclusive growth path? The past experience clearly shows that the road map for building such a banking system may not be smooth. The rural banking has to be integrated with rural development by providing easy and affordable access to finance to rural people. It is no longer an option; it is a compulsion. This requires a package of strategic interventions, which should be built on reorientation of initiatives already undertaken. They should include:

- **Strengthening and expansion of Gramin Banks as the main players in rural banking**: With recent mergers of Gramin Banks at the state level, they emerged as the most suitable and viable rural banking set up in India. There was a significant improvement in their financial performance. Since the commercial banks have limitation to enter aggressively rural financial market, they should consider consolidation of the rural banking structure by hiving-off their rural branches into the Gramin Banks sponsored by them. Gramin Banks should be also adequately capitalized to enable them to expand their network and business in rural areas. The sponsoring banks should also consider them as subsidiary and provide necessary resource and professional support.

- **Revitalization of Cooperatives**: Cooperatives have a large network of more than 1,00,000 outlets. They have institutional capacity to reach out in almost all villages. The cooperatives are, however, saddled with many problems particularly financial health. The reforms of cooperative credit structure are urgently required on lines proposed by the Vaidyanathan Committee in order to

make the primary cooperative credit societies truly democratic, member-driven, professional and viable. Cooperatives should be also actively involved in financial inclusion plan.

- **Building Inclusive Rural Financial System with multi-agency approach:** With a view to significantly increase outreach and financial access to unserved and underserved households at the lower segment of the rural financial markets, building the viable and sustainable inclusive rural financial system is essential. This requires fostering development and integration of an array of grass root level retail organizations such as postal network, cooperatives, SHGs, NGOs and civil society organizations etc as financial intermediaries with the mainstream banking. The use of these agencies as business correspondents (BCs) would enable banks to undertake door-step banking and expand the outreach of financial services in rural areas.

- **Technology-Driven Rural Banking:** The challenging issues in rural banking in the past are the transaction cost, operational viability and sustainability of providing financial services to the rural households at affordable costs. The use of ICT can now address these issues and has the potential to revolutionize rural banking on cost effective basis. Mobile phone, smart plastic cards and ATM can be converted into virtual banking models. Combined with use of banking correspondents, it has the potential for creating a banking outpost in every village.

- **SHG-Bank Linkage as Strategic tool for rural finance:** SHG model can be used successfully as a strategic tool for rural banking. During the last decade, the SHG-Bank Linkage program has made rapid progress in delivering financial services to the rural poor. The challenge is to graduate their members to undertake income generating micro enterprises and sustain them as financial intermediaries to the banks. This would require skill development and capacity building of their members.

- **Capacity Building:** Capacity building is required both at bank and rural household's level. Rural households require capacity building through training to undertake value addition in agriculture and undertake income generating off-farm enterprises. Similarly, viable and sustainable functioning of branchless banking through BC model requires capacity building of bank branches and BCs to undertake banking transactions through ICT based devices. NABARD should prepare tailor-made training modules and implement the same through the banking system.

- **Financial Literacy and Education**: Limited literacy, particularly financial illiteracy is found a significant constraint to financial access at household levels in rural areas. The lack of understanding of banking operations and lack of knowledge about the products and services limits the access to financial services of the rural households. Financial literacy and education campaign and setting up a financial education and counseling office at each rural bank branch for face-to-face counseling would bring the financially excluded into the fold of banking system. The Government has already set up Financial Inclusion and Development Fund with NABARD. The Banks should use this fund for financial literacy and education campaign.

- **Need for Integrating Financial Inclusion Plan with District Plan:** There is a need to prepare comprehensive Financial Inclusion Plans for the districts based on family surveys, mapping of financial service needs of all rural households at the village level and integrate them with Service Area Credit Plan for the village by bank branch coming under his service area, District Credit Plan prepared by the Lead Bank, Potential-Linked Plans (PLP) prepared by the NABARD and District Development Plan prepared by the district authorities. Compartmentalization of developmental initiatives as it is today renders the developmental planning process a ritual.

- **Role of NABARD**: NABARD as an apex body for rural finance should be made responsible for building an inclusive rural financial system. NABARD is already playing an active role in refinancing and promotion of microfinance and SHG-Bank Linkage programs. Following recommendations of Rangarajan Committee, the Government has constituted two funds with NABARD: Financial Inclusion and Development Fund and Financial Inclusion Technology Fund for promotion and facilitating application of ICT for financial inclusion. With the help of these funds, the NABARD can easily play crucial role in developing a viable rural financial system for rural development.

Concluding Remarks

Today rural India is in deep crisis. The road map for rural development requires investment, both public and private, to bring out revolutionary change in rural areas. The rural development should not be merely agricultural centric; instead it should focus on diversification and commercialization of agriculture through agribusiness, value addition in agriculture and development of off-farm enterprises. The banking sector has crucial role to play

in this regard. The banking sector had contributed in the past significantly to drive green revolution to achieve higher agricultural growth. Unfortunately, with financial liberalization, rural orientation of the banking sector lost its momentum. The financial sector reforms reversed this trend. The problem in India is the lack of consistency, continuity and coherent policies; they are muddled with conflicting recommendations of various expert committees and political expediency. They were long on intent and short on delivery. Moreover, the policies change on ad hoc basis, disregarding the imperatives of earlier policies. The banking policies are not exception to this.

The present thrust of financial inclusion should not merely end in opening no-frill accounts. It should be made integral part of achieving inclusive growth in rural areas. This requires easy and affordable access to mainstream banking facilities in rural areas. A consistent and coherent policy is therefore required to build a rural financial system to provide such banking access. Realization of this vision requires multi-agency and multi-pronged approach and coherent area based planning by the banking system. The use of ICT enabled solutions for banking transactions and multiple retail channels by the banking sector will go long way in facilitating expansion of rural outreach. This, however, requires change in the mindset of policy makers, attitudinal change among bankers, change in organizational structure of the banks, change in the financial products and innovative models of delivery at the doorstep of rural households. Unless the banking system considers the bottom of the pyramid rural financial market as a worthwhile banking business opportunity, this vision cannot be realized. The inclusive rural banking will remain a distant dream and financial inclusion for inclusive growth mere a myth.

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