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Rural Credit Delivery in India: Structural Constraints and Some Corrective Measures

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Abstract

In view of the importance of rural credit to agriculture and rural development, this paper has examined a few structural constraints that hamper the credit delivery and has discussed some of the measures taken to improve the situation. The public policy on rural credit in India has been focussed on institutionalisation as a means of providing cheaper credit to farmers. As a result, the share of private moneylenders has decreased substantially from 93 per cent in early-1950s to 31 per cent by 1991. Disturbingly enough, they have emerged as an important source, more so for the resource-poor with a share of 39 per cent by 2002. The multiagency system onset for giving a wide choice to farmers has turned out to be ineffective due to deficiencies of design and architecture. Also, ailing cooperatives, backtracked RRBs and commercial banks with waning interest in rural credit have contributed to the ineffectiveness of the multiagency system, hampering the credit delivery. Several measures have been taken to revitalise the system from time to time. Cooperatives are being given a package assistance for revival following the Vaidyanathan Committee Report. RRBs have been amalgamated and are being given capital to cleanse up their balance sheets. Commercial banks have been successfully involved in 'Farm Credit Package' for doubling the credit and other initiatives of Government of India. The SHG-bank linkage has been promoted on a large scale to supplement rural credit delivery. But, its high transaction costs make it a costly alternative, especially when the business is handled solely by NGOs/MFIs. A thorough overhauling of the rural credit system and its restructuring is the need of the hour. However, it cannot be effective if done alone in isolation without revitalising the Indian agriculture itself.

Introduction

In the post-economic reforms era, Indian agriculture has been subjected to various external and domestic forces that have compelled the farmers to change their product-mix as well as organisation of the farming. Distress has set in the rural economy in many areas, even forcing farmers to commit suicides as an extreme reaction. The major changes that have directly impacted the agricultural sector are financial sector reforms, decontrolling of fertiliser prices, freeing of imports of agricultural commodities, etc. Of these, the financial sector reforms have been crucial in view of its influence on rural credit delivery. The rural credit plays a very crucial role in agriculture and rural economy. And, any disturbance in its delivery mechanism can cause cascading effects. Demand for credit emanates from demand for inputs and services needed for various farm operations. It constitutes a major portion of liquidity with farmers and imparts the needed purchasing power to the capital-starved farmers.

Public policy in the country has always been directed towards ensuring adequate and cheaper

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credit and adopts institutionalisation of credit as the primary focus. Significant progress has been made in institutionalization of rural credit and the credit supply from formal agencies to agriculture has grown year after year, several gaps in the performance notwithstanding.

Today, the rural credit situation looks grim in spite of many measures and constitution of several committees and task forces. It has been a constant target of policy coarctation, especially after 1991 which manifested in three broad areas, viz. enervation of the institutional architecture for rural credit, disincentivisation of credit flow to agriculture through the mechanical application of Basel norms, and squeeze on resources available for agricultural credit operations (Satish, 2007).

In this context, this paper has charted out recent developments in the evolution of rural credit system, highlighting a few structural constraints. The paper has first discussed a few structural problems in the rural credit system that hampered the credit delivery and has then described measures taken to improve it.

Rural Credit System — Existing Structure

In India, we have adopted multi-agency approach to rural credit. From the initial steps to provide Takkavi loans by the Government, cooperatives emerged as the first institutional arrangement to provide loans to farmers. Though Cooperative Act came in 1904, till 1950s the progress in terms of outreach by cooperatives was limited. This led to the Nationalisation of Commercial Banks in 1969 and again in 1980, to step up credit supply to the rural people. Then, came Regional Rural Banks (RRBs) in mid-1970s. Thus, the credit architecture consisted basically of cooperatives, commercial banks and regional rural banks. In terms of agency-wise share in rural credit, the progress of institutionalisation was impressive. The share of institutional agencies in the borrowings of cultivator households increased from mere 7.3 per cent in 1951 to 66.3 per cent in 1991. During 1990s, the share of non-institutional agencies increased to reach 38.9 per cent in 2002. This may be due to increased role of dealers of various inputs in financing cultivators, diminished interest of commercial banks in rural finance after Financial Sector Reforms of 1991, deterioration of health of cooperative system, among others. Ironically, the states with higher degree of commercialization had higher share of non-institutional sources (Satyasai and Viswanathan, 2003).

Table 1 gives the quantum of credit flow to agriculture during the past five years, viz. between

Table 1. Agency-wise ground level credit flow to agriculture: 2003-04 to 2007-08

(in crore Rs)

Agency	2003-04	2004-05	2005-06	2006-07	2007-08	Compound annual growth rate (%), 2003-08
Co-operative Banks	26,875	31,231	39,404	42,480	41,813	13
	(30.9)	(24.9)	(21.8)	(18.5)	(21.7)	
Regional Rural Banks	7,581	12,404	15,223	20,434	22,227	30
	(8.7)	(9.9)	(8.4)	(8.9)	(11.5)	
Commercial Banks	52,441	81,481	1,25,477	1,66,485	1,28,495	28
	(60.3)	(65.0)	(69.5)	(72.6)	(66.7)	
Other agencies	84	193	382	-	-	-
	(0.1)	(0.2)	(0.2)			
Total	86,981	1,25,309	1,80,486	2,29,399	1,92,535	25
	(100)	(100)	(100)	(100)	(100)	

Note: Figures within the brackets are shares in total.

Source: NABARD (2008).

2003-04 to 2007-08. Total ground level credit flow increased at 25 per cent annually during this period to peak at Rs 2,29,399 crore in 2006-07. The credit flow from cooperative system grew at 13 per cent per annum, the lowest among the agencies. As a result, the share of cooperatives in the total credit flow declined from about 31 per cent to a bit below 22 per cent during the same period.

Structural Constraints to Credit Delivery

Ineffective Multi-Agency Approach

The multi-agency system was envisaged to cater to the diverse credit needs and benefit the rural people by giving a wide choice of the agencies to avail credit. But in realty, the rural clientele hardly enjoyed the benefits of the approach as the system suffered from deficiencies in design and architecture. Though multiple agencies existed in the market, they offered different products and to different target groups. Cooperatives have two separate channels for purveying short-term and long-term loans and never showed any coordination between the two channels, putting their members at a disadvantage. RRBs served lower segments of the society which are not generally covered by the cooperatives and commercial banks. Due to security norms and other procedural rigidities, hardly any scope was there for famers to choose any other agency once they entered into contract with any one of the agencies. Besides, deterioration of health of the constituents, waning of their interest in rural lending and short-sighted policies led to dysfunctioning of the system. In what follows, we highlight a few key problems in the constituent agencies in the rural credit system that reduced the effectiveness of the system.

Cooperative System in Muddle

A serious drag on the multi-agency approach is the ineffective cooperative system. Poor health, lack of adaptation to the needs, politicisation, loss of member orientation and credibility *inter alia* disoriented the system. Table 2 gives the health of the cooperative system in the country. It can be easily seen from the table that cooperative system is incapacitated due to heavy losses which invariably increased over the past few years. Cooperatives are ailing in most of the districts and lost their eligibility for NABARD's refinance. This impaired their ability to lend fresh loans and hence, their borrowers lose their freedom to choose the agency or product.

Cooperative system displayed inherent rigidity and did not change with times. It grew bigger in size over time. But, it did not adopt the technology and professionalism needed to manage the structure. Nor it resorted to the restructuring needed. Integration of short-term and long-term structures of cooperatives was mooted by Hazari Committee way back in 1976 as a measure to impart cost economies besides offering all the services through a single window. Except Andhra Pradesh, where integration was done in mid-1980s, no other state pursued this seriously, in spite the positive feed back from Andhra Pradesh experience (Ramireddy, 1996; Satyasai and Viswanathan, 1998). Another measure recommended

Table 2. Health status of cooperative system in India (as on 31 March 2007)

Institution	No. of units	No. of lossmaking units	Accumulated losses (in crore Rs)
State Cooperative Banks (SCBs)	31*	4	385
District Central Cooperative Banks (DCCBs)	367*	95	5681
Primary Agricultural Cooperative Credit Societies (PACS) [Data as on 31 March 2005]	1,08,779	40,388	6,862
State Cooperative Agriculture and Rural Development Banks (SCARDBs)	20	8	912
Primary Cooperative Agriculture and Rural Development Banks (PCARDB)	727	324	2734

Notes: * Six SCBs and 136 DCCBs are not complying with the minimum capital requirements as specified under Section 11 of Banking Regulation Act, 1949 (as applicable to cooperative societies).

Source: *Cooperative Credit Structure: An Overview-2004-05*, NABARD.

for restructuring of the cooperative system is delayering which means removing one tier in the system. As we know, cooperatives have two or three tiers in different states. Either the middle (district level) or top (state level) layer can be removed (Satyasai and Badatya, 2000).

Backtracked RRBs

RRBs were designed to combine local feel and low cost of the cooperatives and professionalism of commercial banks. Somewhere the hybridization process went wrong and what emerged finally was the high cost structure and culture of commercial banks. Due to the restrictions on their client base and the cap on the rate of interest they can charge on their loans, many of them incurred heavy losses. Capital was infused and RRBs were allowed to lend to non-target population and as of now RRBs can lend to anyone without any restriction and are almost on par with any other commercial bank in business scope.

The performance of RRBs had not been very impressive all along. One reason often quoted is their faulty design, as they were to lend at lower rates than their cost of funds. The net profit of RRBs at the aggregate level increased from Rs 617.13 crore during 2005-06 to Rs 625.15 crore during 2006-07. The net worth of RRBs increased to Rs 4,526.48 crore during 2006-07, an increase of 13 per cent over the previous year. The performance of RRBs varied widely across regions. While all RRBs were in profit in the southern region, 29 (out of 31) in central, 14 (out of 16) in northern, 9 (out of 10) in western, 9 (out of 10) in eastern and 5 (out of 8) in north-eastern regions were in profit (NABARD, 2008).

Shrinkage in Commercial Banks' Involvement

Public sector commercial banks played a major role in rural transformation since their first phase of nationalization in 1969. Rural branches increased in number and banking network spread across the country. Commercial banks' share in total institutional credit also kept on increasing over time to reach over 60 per cent by 2003-04 (Mohan, 2006). However, after the Financial Sector Reforms, 1991, the commercial banks were asked to show profitability and viability and follow prudential norms of income recognition and asset classification. Added to this, a host of new private sector banks were permitted and foreign banks were allowed to operate, thereby mounting heavy competitive pressure on the public sector commercial banks. The public sector commercial banks entered into a race with the private and foreign banks for the urban segment rather than concentrating on semi-urban and rural segments where they have heavy presence and initial advantage.

As a result of liberalization in branch licensing policy, the rural branches dwindled in numbers after 1991, both in absolute and relative sense. The proportion of rural branches declined from 57 per cent in 1990-91 to 44.5 per cent in 2005-06 (Table 3). On an average, number of rural branches came down by 260 every year.

As a result of reduction in number of branches and general relaxation in the emphasis on priority sector lending, commercial banks' involvement in rural credit declined. The major brunt appears to have been borne by the weaker sections. Inequitable distribution of branch network and credit flow across regions is already well documented. Imagine the plight of weaker sections in a region with weak banking spread! The Situation Assessment Survey (SAS) of Farmers (59th Round NSSO) conducted in the year 2003, has estimated that over 50 per cent of farm households were financially excluded with a relatively higher proportion of exclusion among small and marginal farmers and tribals (NSSO, 2005). As per Chavan (2007), commercial banks were the most important source of credit for the *dalit* households in 1992 and the share of debt from commercial banks to *dalits* sharply declined between 1992 and 2002. The vacuum, thus created, was filled

Table 3. Number and proportion of rural branches of commercial banks

Year	Number of rural branches	Percentage to total
1990-91	35,134	56.9
1996-97	32,909	50.5
2000-01	32,640	48.3
2005-06	30,750	44.5
Linear growth rate/year	(-) 260	(-) 0.77

primarily by professional moneylenders. While professional moneylenders did emerge in 2002 as an important source of credit for other rural households as well, their hold was much stronger over *dalit* households than other households. Commercial banks data also indicated a growing failure on the part of domestic banks to meet the targets set for "weaker sections" (which included *dalits*) after 1991. This finding has serious implications as, going by the history, high cost credit was used to rob the poor of their assets like land. Less dangerous, though ubiquitous, are the linked credit transactions where farmers may lose substantially and have been widely reported in the literature. A trader giving credit and indirectly forcing, with likelihood of exploitation, the farmer to sell through him in the product market is a common feature in the rural areas.

Yet another reason for the reduced commercial banking activity in rural areas is the staff restructuring. At one point in time, say, for about decade and a half after the bank nationalisation, public sector commercial banks recruited professional staff (agricultural graduates and other specialists). From 1990s onwards, in the wake of the much hyped VRS scheme, they had to manage their business operations through a handful of not-so-well-suited personnel in many branches. This naturally reduced the outreach as well as quality in lending. Rural lending in a country like India is manpower-intensive and the cost control through staff pruning would be self-defeating and counter productive.

It appears that the number of agencies in a system, thus, may not matter as much as their commitment to the rural development and adaptability to the emerging demands.

Efforts to Improve Credit Delivery

Revitalisation of Cooperative System

Several initiatives were taken from time to time based on the recommendations of many committees to suggest ways to revitalise the cooperatives with limited success. Recently, Government of India has announced revival package based on the recommendations of the Task Force on Short-Term Rural Co-operative Credit Structure (STCCS) (Chairman: Dr A. Vaidyanathan), with an outlay of Rs 13,596 crore. The assistance is to be provided for cleansing the balance sheets of STCCS (as on 31 March 2004), capital infusion to ensure CRAR of 7 per cent, technical support for building up common accounting and internal control system, computerisation, etc. NABARD has been actively involved in administering the programme and training the staff, board members and other elected representatives of PACS. Importantly, at end-March 2008, six states (Andhra Pradesh, Gujarat, Haryana, Madhya Pradesh, Orissa and Uttar Pradesh) have passed bills to amend their Co-operative Societies Act (CSA) and Maharashtra has promulgated an Ordinance. As on 31 March 2008, the total support released to states reached Rs 3,659.05 crore, including state government share of Rs 333.93 crore.

The Government of India has also announced similar package for Long-Term Co-operative Credit Structure (LTCCS), based on the report of the Task Force under the Chairmanship of Prof. A. Vaidyanathan in the Union Budget 2008-09. The financial assistance is estimated at Rs 4,584 crore as well as legal and institutional reforms.

How quickly the cooperatives can be revived to be able to serve their members and how much confidence and sense of belongingness can be imparted among the members through trainings is a big question. Financial revival may take place soon. But, revival in true sense may take decades, if at all (EPWRF, 2007).

One major drawback in the cooperative system is that credit and marketing cooperative systems are separate and are never integrated functionally. True multipurpose societies with credit and marketing (non-financial) services can improve the viability of PACS and provide one-stop solutions to farmers to enhance their viability too.

Two important structural changes took place in RRBs in recent years. First is the amalgamation of RRBs according to sponsor commercial bank from 2005-06 onwards. As a result, the number of RRBs has been reduced from 196 to 96 as on 31 March 2007. Second, RRBs are directed to cover hitherto

uncovered districts in the Union Budget 2007-08. That is, 49 hitherto uncovered districts will be covered by them as notified by Government of India and 11 districts are under consideration for notification. Of the 678 proposed branches, 268 were opened as at end-March 2008.

The recapitalisation support announced by Hon'ble Finance Minister in the Union Budget 2007-08, will be extended to RRBs with negative net worth in a phased manner. As at end-March 2008, out of 96 RRBs, 27 (28%) had negative net worth, requiring recapitalisation support worth Rs 1,795.97 crore (Rs 66.5 crore/RRB). The Government of India, sponsor banks and sate governments will contribute in the ratio of 50:35:15. Six state governments have contributed their share to 12 RRBs, fully or partly, so far.

Kisan Credit Card (KCC) Scheme

The Kisan Credit Card (KCC) scheme, introduced in August 1998, has facilitated flexible, easy and timely credit delivery to farmers. KCC can be used to avail crop loans, term loans and consumption loans. Of the total 714.68 lakh cards issued as on 31 March 2008, co-operative banks accounted for 49 per cent of the share, followed by commercial banks (37%) and RRBs (14%). Kisan Credit Card improved the farmers' accessibility to bank credit, simplified credit delivery procedures and provided more flexibility in use of credit. However, some areas of concern remain to be addressed like low level of awareness among farmers with reference to the right use of KCC, inoperative accounts, etc.

Farm Credit Package

In 2004, Government of India announced a package for doubling the credit flow to agriculture, from Rs 80,000 crore in 2003-04, in three years. On account of concerted efforts, the target was achieved in just two years by adopting various measures like revision of scales of finance, units costs, coverage of new farmers, issue of comprehensive credit cards, etc. While the quantum jump was impressive overtime, there was sub-sectoral bias towards farm mechanisation and refocus on irrigation, land development, horticulture, agro-processing is necessary (BCCI, 2008).

Self-Help Group (SHG) - Bank Linkage and Micro-Finance Institutes (MFIs)

As we have seen earlier, some sections of the population remained without access to formal banking channels. A micro-finance programme was started in the country to supplement the efforts of formal banking system and provide access to banking services to large masses. The SHG - Bank Linkage Programme in India started as a pilot project of linking 500 self-help groups across the country during 1992-1995 (Pilot testing period), followed by mainstreaming during 1996-1998 and expansion since 1998 onwards. Beginning with a modest number of 255 SHGs being linked during 1992-93, 25,84,729 SHGs were linked with banks by February 2007. Micro-finance Institutions (MFIs), institutions other than banks that are engaged in provision of financial services to the poor, emerged to fill the gap due to poor network of banks. The cost of delivery was, however, very high in channels with involvement of NGOs alone. Puhazhendhi (2007) has estimated the cost of delivery of Rs 100 credit under various models based on studies in three states of Rajasthan, Tamil Nadu and West Bengal. The comparative estimates are given in Table 4.

Cost of delivery through SHGs includes two components – cost of promotion and nurturing the group and cost of delivery. While transaction cost is maximum in the Model III, where MFI acts as the promoting and financing agency, the major component is cost of promotion. Mostly this can be one-time cost in the first one or two years. In subsequent years, the cost of nurturing, or more precisely, cost of keeping the herd together, can be minimal in Model III, as groups formed by MFIs are likely to remain intact for a longer period since they spend more time with the groups during the formation and thereafter. In any event, the fact remains that models with involvement of banks turn out to be cheaper in credit delivery due to higher loan volumes and less time spent on delivery, perhaps, due to their experience. Also, the SHG linkage is concentrated mostly in southern parts of India and has not spread to areas where bank network is poor (Satyasai, 2000). Hence, the programme cannot be expected to yield miraculous results in terms of correcting the imbalances in the outreach.

Table 4. State-wise loan size and transaction costs of lending per Rs 100 – Model-wise

(in Rs)

State	Model I: Banks taking financial and non-financial roles		Model II: NGOs playing non-financial role and banks, financial role		Model III: NGOs playing financial and non-financial roles	
	Average loan	Transaction costs	Average loan	Transaction costs	Average loan	Transaction costs
Rajasthan	14,804	2.32	17,572	2.96	7,462	4.15
Tamil Nadu	13,000	1.91	15,680	2.61	8,200	5.51
West Bengal	14,358	2.43	16,251	2.44	5,860	5.12
Average	14054	2.85	16501	3.53	7174	6.76
Cost of group promotion/ Intermediaries		8.63		8.91		9.42
Total transaction costs		11.48		12.44		16.18

Source: Puhazhendhi (2007).

Summary and Conclusions

Public policy on rural credit in India has been focussed on institutionalisation as a means of providing cheaper credit to farmers. As a result, the share of private moneylenders had decreased substantially from 93 per cent in early-1950s to 31 per cent by 1991. Disturbingly enough, they have emerged as an important source, more so for the resource-poor with a share of 39 per cent by 2002. The multiagency system onset for giving a wider choice to farmers has turned out to be ineffective due to deficiencies of design and architecture. Also, ailing cooperatives, backtracked RRBs and commercial banks with waning interest in rural credit have contributed to the ineffectiveness of the multiagency system, hampering the credit delivery. Several measures have been taken to revitalise the system from time to time. Cooperatives are given a package assistance for revival following Vaidyanathan Committee Report. RRBs have been amalgamated and are being given capital to cleanse up their balance sheets. Commercial banks have been successfully involved in Farm Credit Package for doubling the credit and other initiatives of Government of India. The SHG-bank linkage has been promoted on a large scale to supplement rural credit delivery. But, the high transaction costs make it a costly alternative, especially when the business is handled solely by NGOs/MFIs. A thorough overhauling of the rural credit system and its restructuring is the need of the hour. However, it cannot be effective if done alone in isolation without revitalising the Indian agriculture itself.

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