Research Paper

Volume : 1 | Issue : 7 | Dec 2012 • ISSN No 2277 - 8179

Rural Banking Challenges in India

Banking

KEYWORDS : Economic reforms, Bank nationalization, Rural banking, Branch expansion

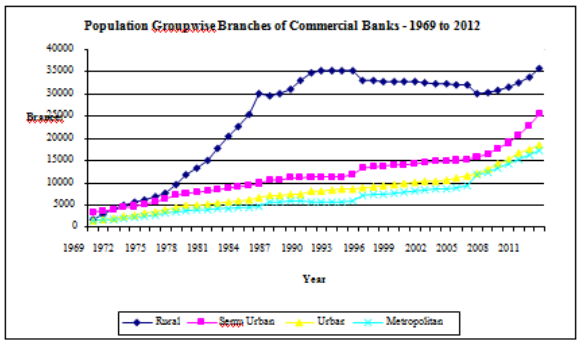
Dr Mahalaxmi Krishnan Associate Professor of Commerce, K J Somaiya College of Arts and Commerce, Mumbai, PhD Guide in Management Studies, SNDT University

ABSTRACT

With only 50,000 of the 600,000 villages having access to finance, there is an imperative need to accelerate branch expansion in rural areas. India has the highest number of households (145 million with 800 million people) excluded from banking. RBI and the government therefore plan to extend financial services to every nook and corner in the next five years. This is an uphill task by any standard. This research paper looks at the challenges faced by Indian banks in the backdrop of the RBI push towards rural banking.

1. Introduction

Bank nationalization in 1969 transformed the Indian banking scene. Banking services expanded across the length and breadth of the country. Nationalized banks' thrust on opening rural branches helped rural people to access banking services. The graph below gives panoramic view of branch expansion since 1969.



Banking sector reforms as a consequence of the economic reforms since 1991 gave further fillip to the growth of the banking industry. Entry of private banks intensified competition. Bank automation enabled banks to offer many new banking products and services and many value added services such as ATMs, plastic cards, internet banking, etc. Advancements in communication technology helped in computerizing branches in rural areas and setting up ATMs. However a closer look at branch network reveals divergent trends before and after 1991 as can be seen from the following Table.

Comparative Growth of Commercial Bank Branches - Pre and Post Economic Liberalization in 1991

YEAR	RURAL	SEMI-URBAN	URBAN		TOTAL
1969 No.	1833	3342	1584	1503	8262
1969 % share	22	40	19	18	100
1991 No.	35206	11344	8046	5624	60220
1991 % share	58	19	13	9	100
2012 No.	35850	25439	18625	17197	97111
2012 % share	37	26	19	18	100

Source: RBI Handbook of Statistics, 2012

After nationalization there was rapid growth in rural branches as a result of which its share in total branches increased from 22% in 1969 to 58% in 1991. In terms of numbers, there was a phenomenal growth from 1,833 branches in 1969 to 35,206 branches in 1991. However in the two decades since 1991, it remained almost stagnant while urban and metropolitan branches increased. This is partly due to urban centric private sector banks and general consolidation by the public sector banks with emphasis on induction of new technology based systems, products and services. As a result the share of rural branches in total branches declined to 37% in 2012. During the same period, the share of metropolitan branches doubled from 9% in 1991 to 18% in 2012. There is growth in semi urban and urban branch network as well.

It can be seen from the above graph that rural branches growth plateaued since 1991 while branch expansion in other population groups are on the incline. While the economic reforms have helped the Indian economy, the benefits are not trickling down to the rural areas at the desired speed. Many of the socio-economic measures of the government are not reaching the rural mass due to absence of banking channels. The RBI's branch expansion policy once again emphasizes on opening rural branches in the hitherto unbanked areas.

2. Rationale for the Present Study

For bringing rural population to the mainstream economy, the most important is the coverage of bank presence in rural sector. The number of bank branches is not enough to serve the entire rural population. Still there are many villages where there is not a single bank branch to serve the needs of the villages.

The current RBI Branch Expansion Policy once again exhorts banks to open branches in large numbers in rural areas with specific time lines. This paper looks at the consequent emerging challenges in rural banking.

3. Objectives of the Study

i. to study the challenges of rural banking in the light of the new RBI branch expansion policy, and
ii. suggestions for revitalizing rural banking

4. Research Methodology

Data and information for the research study were collected and analyzed from secondary published sources viz., books, newspapers, web sites and research studies.

5. Findings of the Study

5.1 Challenges of Rural Banking

Major challenges of rural banking are:

- By 2013, banks have to cover all unbanked villages with population of more than 2000. There are about 73,000 such villages that have no formal banking channel. RBI wants that over the next five years, villages with a population of less 2000 should also have basic banking facility by way of brick and mortar branches or through business correspondents (BCs).
- The sheer numbers of the mandate is mind-boggling. Nearly 200,000 BCs / CSPs (Customer Service Points) would need to be deployed by 2013. More than 4,000 branches will have to be opened in unbanked villages along with 10 crore no-frills accounts. Banks also plan to issue over 30 million KCCs and about 7 million GCCs by March 2013. The overall costs to the banks for the financial inclusion would be Rs.3,000 to Rs.4,000 crore pa. Banks would have to outsource large part from technology providers to identifying BCs
- To supplement the efforts of the existing players, RBI is examining permitting industrial houses and big corporations to set up banks. While this will help spread banking across the country, the concerns of the RBI are conflict of interest, risk of funds being diverted to affiliates of the industrial

houses, concentration of economic power, likely political affiliations undermining the independence and neutrality of banks as arbiters of credit allocation to the real sectors of economy, potential for regulatory capture, governance, safety net issues, etc. But in view of the large developmental needs of the economy, there is need for large capital investments in the banking sector.

- Providing institutional credit to the rural poor and thereby freeing them from the clutches of the money lenders is a hard nut to crack for the policy makers. The issue needs serious attention. Actually, without adequate provisions of credit to rural sector, it is not possible to think of expanding rural banking in the country. In fact, rural credit and rural banking have become synonyms in the Indian context. It is now essential to replace conventional credit mechanism with innovative credit mechanism in the rural sector.
- Another issue is related to no-frills accounts. No-frills savings account is an innovative product that has the potential to inculcate the habit of saving among the rural poor. The product has not been successful. On the demand side, there is a lack of pressure from the bottom and on supply side, banks seem to be least interested to market the same due to the low profitability attached to the product. SBI with its vast presence in rural areas is making efforts using mobile technology and RFID. The SBI – India Post Alliance is case in point for widening the banking habits among the rural poor. More such innovative approaches involving more banks are required to widen the net.
- On technology front banks have achieved a major milestone with almost all bank branches in CBS platform. All commercial banks have progressed far in automation of their core services. However, banking reaches only 40% of the population. There are vast areas of rural India which are still unbanked. This has resulted in more than 60% of the financial transactions being cash based.
- One of the major issues related to rural banking is the customization of the products offered by various commercial banks. Most of the banking products have been designed keeping in mind the urban and metro customers.
- Rural banking requires more manpower for distribution of banking services. For example, while about 30 bank employees may be required to do micro-finance business of Rs.1 crore, SME of similar size would require only one or few bank employees. It has its own implications in terms of cost and the profitability of the bank branches which operate in rural sector of the country.
- The issue of inequality in rural banking is one of the major concerns. Policies of financial liberalization have worsened regional inequalities in rural banking in India.
- While India takes pride in its GDP growth rate, people below poverty line continue to languish. About 24% of Indian population is in this category. 60% of the population and 51% of the cultivator population are out of the ambit of the banking system. Apart from this poverty issue, persons with banking relationships are also not at an acceptable level. The number of bank accounts can easily be doubled through vigorous financial inclusion efforts. While actions have already been initiated through micro-finance and other initiatives, there are challenges involved like suitable delivery models, the reaching out process, transaction costs, etc. More research and analysis are needed to make financial inclusion a success. Otherwise, India could be missing out on its demographic advantage.

These issues require collective efforts and cooperation on the part of policy makers, commercial banks as well as rural public.

5.2 Revitalizing Rural Banks

Following are some of the recommendations for revitalizing rural banking.

- Since RRBs have low cost of administration, they should be revitalized as they have the potential to serve the credit needs of rural people in the best way.
- Rural credit market should be restructured and renovated to suit the specific requirements of the people. Micro credit approach is an effective tool for resolving issues related to rural credit such as non recovery of loans and for bringing more number of rural poor into the institutional credit net. Though micro financial institutions play important role in rural banking, still the role played by the commercial banks, cooperative banks and RRBs cannot be undermined.
- Norms related to priority sector lending must be enforced meticulously so that people belonging to poor strata of the society can get rid of money lenders and other informal sources of credit which are highly exploitative in nature. Penalties must be imposed on the banks which fail to meet their targets regarding priority sector lending programs.
- Problem of chronic rural indebtedness cannot be solved merely by changing banking policies. Agrarian reforms are required which require government intervention.
- No-frills accounts should be promoted through various marketing strategies. It will create demand for these accounts among rural poor and result in greater financial inclusion. RBI must instruct banks including foreign banks operating in India to promote no-frills account as a part of their social responsibility.
- Banks should customize their products to serve the people living in villages as most of the banking products have been designed to serve urban and metro customers.
- For rural banking, public – private partnership can produce wonderful results. ICICI Bank's efforts in this area have already attracted the attention of policy makers and banking experts.

Conclusion

RBI has directed that within the next five years the banking system must be extended to India's villages as part of financial inclusion. But a profitable business model for banking the unbanked remains elusive. Since ensuring comprehensive physical presence with brick and mortar branches is difficult, banks have to explore using modern information and communication technologies and other means of outreach such as business correspondents and the emerging 3G technologies to expand their reach in rural areas and promote financial inclusion.

REFERENCE

1. Chipalkatti N, Rishi M (2007), "A post reform assessment of the Indian banking sector: profitability, risk and transparency | 2. Sultan Singh, "Banking Sector Reforms", Kanishka Publications, Delhi | 3. Shrivastava M P, Singh S R, "Indian Banking in the New Millennium" | 4. Handbook of Statistics on the Indian Economy, RBI 2011-12 | 5. http://www.rbi.org.in