Rural Management -Rural Banking

# Rural Management
# Rural Banking

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## About the Book

Rural Banking has come a long way since independence. During the first two decades after independence the co-operative banks were the vehicle for rural lending. The landscape was dominated by private commercial banks that were averse to rural lending because of the perceived high risk and low returns. The co-operative banks were neither efficiently managed nor they had the resources to single-handedly cater to the rural credit demand. The Government needed the support of the commercial banks to spread the credit network among the farmers who needed resources to fulfill the demand for inputs required for success of Green Revolution. Achieving self-reliance in food production was the immediate goal of the Government and with this objective it nationalized 14 private banks. It was a paradigm shift from class banking to mass banking.

The seventies and eighties marked the rapid spread of banking in the countryside through a multi-agency approach namely the Commercial banks, Regional Rural Banks and Co-operative Banks. There was multifold increase in the flow of credit to agriculture and allied sectors. However, everything was not hunky- dory. The lending agencies were burdened with impaired assets due to burgeoning loan defaults causing rapid erosion of capital in many banks. The nineties witnessed the liberalization of the banking sector and increased competition with the arrival of private banks. The non-performing regional rural banks were merged with profitable ones to reduce the mounting losses. There was shift in mode of delivering banking services from branch-based banking to electronic banking by leveraging technology. Issue of Kisan Credit Card and General Credit Card announced the arrival of digital age in rural banking. Delivery of banking services in remote areas through third parties like Banking Correspondents and Banking Facilitators gained popularity, riding on internet technology.

In the next decade there was tremendous focus on financial inclusion where the goal was to bring the unbanked population under the ambit of banking. The population of bank account holders jumped leaps and bounds though the usage of the accounts remained low. Most of the accounts were dormant. To address this issue the Government decided to transfer the social subsidies directly to the beneficiary account through the banking system forcing people to use the account. To further the cause of financial inclusion the Government came up with the idea of Small Finance Banks, to serve that sector of the economy which is not served by mainstream banks. Like the Regional Rural Banks, they also have seventy five percent priority sector lending target.

The idea of writing a book on Rural Banking has been germinating in our mind for many years. A request from MGNCRE to write a text book on a variety of topics in rural management course provided the opportunity and inspired us to undertake the task. In writing this book we have attempted to blend the academic and practitioner's perspective based on the experience in industry before moving into academics. The book is designed to provide the students a foundation understanding of the wide variety of banking activities falling under the ambit of rural banking. Keeping the requirement of management students in mind we have made an attempt to present the text in a lucid and simple style. However, its usefulness is not confined to management students alone. It may be of equal interest to those who are in search of knowledge in the field of Rural Banking.

I would like to thank Ardhendu Shekhar Singh, Associate Professor at Symbiosis School of Banking and Finance, Symbiosis International (Deemed University), Pune and Dr. Debashish Kundu, Ph.D. (Aligarh Muslim University), Associate Professor at Development Management Institute, Patna for contributing to this book and for their outstanding insights. I would like to thank MGNCRE Team Members for extending extreme support in completing this book.

**Dr W G Prasanna Kumar**
**Chairman MGNCRE**

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# Chapter 1 Introduction to Rural Economy

## Introduction

Rural economy has been playing an important role towards the overall economic growth of the country. The rural economy is identified by two key aspects: 1) Agriculture which is the prime occupation in rural areas and 2) Poverty which is omnipresent in the rural economy. India has been predominantly an agriculture-based country and it was the only source of livelihood in ancient times. However, the contribution of agriculture in the national economy has been declining over the years. This decline in share of agriculture in the national income does not reduce its importance because it provides food security to 130 crores population and employs 58 percent of the labour work force. We have attained food surplus, moved away from subsistence agriculture to commercial agriculture and we are even exporting agriculture produce.

As the value addition by agriculture to national income declines it is necessary to shift the rural employment from farm to Non- Farm Sector. Non- farm sector promises to generate more and more employment opportunities in rural areas in near future. Development of Non- Farm sector will also mitigate the problem of migration from rural to urban areas resulting in an increased pressure on urban infrastructure.

Low income and inadequate savings leave very little scope for rural poor for capital formation and investment. The poor can break the cycle of poverty only when they have access to capital which they can invest to augment the income. Rural Economy needs finance for various reasons like- household consumption, purchase of agriculture inputs (working capital), cope up with crop failures, purchase assets or fulfill social obligations. They can take finance either from institutional or non-institutional sources. Government has always attempted to bring the rural masses under the purview of institutional sources of finance so that they get adequate credit at affordable rates and do not fall into the clutches of moneylenders. However, even now a large portion of marginal farmers do not have access to institutional credit.

Over the years India has achieved self- sufficiency in agriculture production. It is now a food surplus country. Indian agriculture has transformed from subsistence to a commercialized activity. However still it is besieged by lot of challenges which impede its growth potential. Apart from credit, Indian agriculture faces various problems like fragmented land holding, lack of irrigation, low yield, lack of security of tenor, and lack of market infrastructure which needs to be addressed.

## Objective

The objective of this chapter is to impart to its readers a sense of importance of the rural economy for the development of the country and the factors which needs to be prioritized to improve the rural economy. After reading this chapter the students will learn to appreciate the following:

1. Characteristics of rural economy and its importance
2. Why finance is needed in rural economy
3. Importance of Agriculture as the backbone of Rural Economy
4. Salient features of Indian Agriculture
5. Obstacles faced by Indian Agriculture

**Chapter Structure**

- 1.1 Introduction to Rural Economy
- 1.2 Importance of Finance as a Scarce Resource
- 1.3 Need for Financing Rural Economy
- 1.4 Agriculture and Allied Activities
- 1.5 Challenges to Indian Agriculture- Rural Unemployment

## 1.1. Introduction to Rural Economy

Rural economy has been playing an important role towards overall economic growth of the country. Agriculture has been the pillar of rural economic growth and the predominant source of livelihood in rural areas. Our country has come a long way from being a food deficit to a food surplus country. Several pockets of agriculture prosperity have been developed that have led to investments in industry and other segments.

Before discussing about the rural economy, it is imperative to understand the definition of Urban and Rural. The National Sample Survey Organization (NSSO) defines 'rural' based on the undermentioned criteria:

- **i.** Any area where density of population does not exceed 400 per square kilometer,
- **ii.** Villages with clear surveyed boundaries but no municipal board,
- **iii.** At least 75% of working male inhabitants are engaged in agriculture and related activities

Reserve Bank of India defines rural areas as those with a population of less than 10000. RBI has classified the entire geographical area of the country based on population which is seen in **table 1.1**:

**Table 1.1:** Population Group Wise Classification of Banking Centres

| Population Group Wise Classification of Banking Centres | |
|---|---|
| Rural Centre | Population up to 9999 |
| Semi-urban centre | from 10,000 to 99,999 |
| Urban | from 1, 00,000 to 9, 99,999 |
| Metropolitan | 10, 00,000 and above |

**Source**: RBI 2016-17

Rural Economy is characterized by agriculture and allied industries as the primary occupation. Allied Industry further comprises of the sub-sectors of agriculture -forestry, fisheries and Livestock.

Nearly 68.9 percent of total population of our country stays in rural areas. Between 2000-2001 and 2010-11 the proportion of rural population declined from 72.19 per cent to 68.9 per cent. The growth rate of rural population also slowed down between 1991-2001 and 2001-2011 by 5.9 per cent. The decrease in proportion of rural population is attributed to the decreasing livelihood

opportunities which forces village people to migrate to urban areas for livelihood. Another reason is that, in the ten-year period many rural areas have been included in urban category**.** The importance of rural economy can be derived from the fact that it provides food to 130 crore population and employment to 58% the total labor force in the country**.** It is the foundation for food security of the country.

The two most prominent features which are synonymous with rural economy are agriculture and poverty. Both these aspects have deeply influenced the policies related to rural development. In recent times the value addition by agriculture to the national economy has been reducing and hence its employment generating ability has also declined. In this scenario the rural non-farm enterprises have gained prominence because they have the potential to provide employment to rural masses thus reducing the employment saturation in agriculture.

**About Agriculture**

Agriculture is the main occupation of 70% of the rural population. In India agriculture is largely monsoon dependent. About 90 percent rainfall in the country is received during June to September and rest of the year there is a dry spell. The distribution of rainfall is much skewed, with North East Region getting more than 100 cm of annual rainfall and Rajasthan getting only 15 cm. There have been many years when the North West monsoon has failed pushing the farmer into poverty and distress. Such uncertainty of rainfall and its uneven distribution has adversely affected the stability of farmer's income.

In most places with scanty rainfall only one crop is grown in a year so there is employment only for 3-4 months in a year. Those who have access to alternate source of irrigation are able to raise two or three crops but they have to incur additional expenditure which raises the cost of production.

Other than rainfall, Indian agriculture is plagued by lot of issues like low farm productivity, fragmented landholding, paucity of markets in vicinity of the farm, inadequate access to credit etc. which leaves little scope for mechanization and technological advancement, higher productivity and ability to bargain for remunerative prices. Income from farming is generally very volatile because of dependency on rainfall and effect of all the adverse factors mentioned above and hence financial institutions perceive high risk in lending to farmers.

**Agriculture in India has mainly three crop seasons:**

- **i.** Kharif Season – The crops sown during the period July to October are known as kharif crop. It covers the south west monsoon season
- **ii.** Rabi Season – Crop sown during the period of October to March are known as Rabi Crop. It covers the winter season
- **iii.** Zaid Season – Crops grown in summer between March to June are called Zaid Crops. It is a minor season where crop cultivation happens only if there is availability of irrigation facility

In most parts of the country the employment opportunities in agriculture is limited to only 2-3 months in a year in rain-fed areas which is one of the key reasons for low income and poverty in villages.

**Rural Poverty**

Poverty levels are high in rural areas compared to urban areas. As per Prof. Tendulkar committee report (2011-12) nearly 25.7 percent of the rural population live below the poverty line. The definition and criteria for classification of poverty was later revised in 2011-12 by Rangarajan Committee. According to revised estimate the rural poverty was pegged at 30.9 percent.

**Table 1.2:** Percentage of Population below Poverty line

| Particulars | Percentage of Population Below Poverty Line | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2004-05 | | | 2009-10 | | | 2011-12 | | |
| As per Prof Tendulkar Committee | Rural | Urban | Total | Rural | Urban | Total | Rural | Urban | Total |
| | 42 | 25.5 | 37.2 | 33.8 | 20.9 | 29.8 | 25.7 | 13.7 | 21.9 |
| As per Dr C. Rangarajan Committee | - | - | - | 39.6 | 35.1 | 38.2 | 30.9 | 26.4 | 29.5 |

**Sources:** Census 2011

The reasons for rural poverty are mainly related to the paucity of income from agriculture which is the main occupation of rural households. The reasons can be summarized as follows:

1. Population density in our country is high so per capita land holding is very less. As a result, the production per unit of land and the total income is also very less. Between 2000-01 and 2010-11 the average landholding size reduced from 1.33 hectare to 1.15 hectare.
2. Crop production in our country is dependent on vagaries of nature and there is occasional failure of crop either due to drought or due to flood. Agriculture in most part of the country is rain fed. There is no certainty of income from agriculture.
3. Low productivity in small landholdings restricts the farmer from availing benefits of economy of scale like purchasing inputs at negotiated prices or selling in bulk for better price recovery. There is very little potential to increase income.
4. Low production also deprives the farmer from bargaining for remunerative prices so income remains stagnant.
5. Warehouse and cold store facilities are limited so the produce cannot be stored for better price recovery in lean season. Distress sales take place when there is surplus production.
6. Institutional credit is far-fetched due to lack of documents required by such credit institutions. Hence the farmer is dependent on non-institutional sources of credit at usurious interest rates which pushes them into perpetual debt, especially after a crop failure.
7. Low Land holding size adversely affects the scope for farm mechanization and adoption of better technology for sustainable farm incomes.
8. Lack of Agriculture Value Chain also leads to poor value addition of agricultural produce and remunerative prices.
9. Delay in adequate and timely availability of agricultural credit from financial institutions, to the small and marginal farmers who require maximum credit support.
10. Paucity of agriculture markets in the vicinity of the farm and market imperfections.

**Share of Agriculture in the Economy of the Country**

The total value of all product and services produced within a country during a year is known as Gross Domestic Product (GDP). National Income is the aggregate factor income which arises from the production of total outputs.

Over the years the share of agriculture sector in the total nominal GDP has reduced from 57.7 percent in 1951 to 16 percent in 2019 as depicted in figure 1.1.

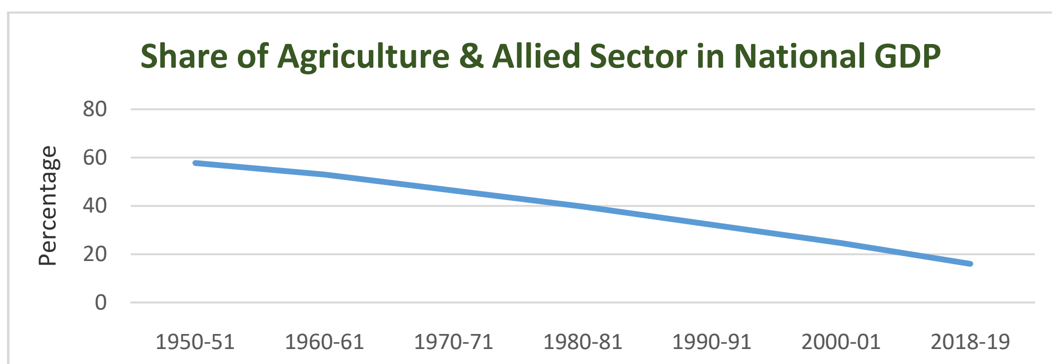


**Figure 1.1:** Share of Agriculture & Allied Sector in National GDP

**Source:** Agriculture Statistics at a glance, 2018

The decline in the share of agriculture is in line with the pace of economic growth of the country. It has been observed globally that as a country develops and the per capita income rises, the share of agriculture in national income decreases. This primarily happens because of three reasons:

i. Agricultural products are less income elastic than non- agricultural products. Their consumption increases less with rise in income, so value addition is less.
ii. The use of inputs from non- agricultural sector in agriculture increases due to technological advancement so the value added by agriculture gets shared between them.
iii. Many Agricultural intermediates are used as input by the industry so the share of agriculture in per rupee earned decrease.

The Agriculture GDP grew by 3.3 percent during the 11th five-year plan which is below the planned target of 4 percent for the entire period. The agriculture growth has been inconsistent since the last few years; the highest being 6.3 percent and the lowest being -0.2 percent (Table 1.3). In 2014-15 there was negative growth due to the drought situation which effected agricultural production.

**Table 1.3:** Gross Value Added at Basic Prices by Economic Activities

| Particulars | Gross Value Added (GVA) at basic prices by economic activity at constant (2011-12) prices | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | **2011-12** | **2012-13** | **2013-14** | **2014-15** | **2015-16** | **2016-17** | **2017-18** | **2018-19** |
| **Agriculture, Forestry & Fishing** | 1501947 | 1524288 | 1609198 | 1605715 | 1616146 | 1717467 | 1803039 | 1852580 |
| **Growth in Agriculture GVA** | | 1.5 | 5.6 | -0.2 | 0.6 | 6.3 | 5 | 2.7 |

**Sources:** Agricultural Statistics at a Glance, 2018

**Rural Enterprises**

After having mentioned about the agriculture it is necessary to mention about the rural enterprises which are a very important source of employment in villages and a critical component of rural economy. The sixth economic census mentions that out of 58.5 million enterprises in the country 59.48% are located in rural areas and only 40.52% are located in urban areas. It highlights the fact that rural areas are the hub of most of the entrepreneurial venture and if conducive environment and factors needed for growth of such ventures are provided, the rural areas can generate employment and income and reduce their dependence on urban location for jobs.

The rural enterprises can be categorized as Rural Farm Sector Enterprises and Rural Non-Farm Sector Enterprises. By Rural Farm Sector Enterprises (RFS) we refer to the agriculture-based industry like rice mill, oil mills, cotton ginning units, food processing units, sugar factory, dairy units etc. Nearly 92.03 percent of agro-industry is located in rural areas while only 7.97 percent are in urban location.

The Rural Non-Farm Sector (RNFS) includes a host of activities which are not related to agriculture like mining & quarrying, repair of farm equipment, construction, trade, house-hold based manufacturing, transport and other services in locations up to 50000 populations. Nearly 50.06% of the rural non agriculture enterprises are located in rural areas while 49.94% are urban based. The RNFS provide 68.99% of the total employment in rural areas.

**Figure 1.2** shows the distribution of enterprises based on location and type as mentioned in the sixth Economic Census, 2015. It excludes the enterprises involved in crop production and plantation activities. Majority of the rural enterprises are Non- agriculture enterprises and most of them are managed by family members without hired labor. Even Agricultural enterprises are family managed without hired worker.

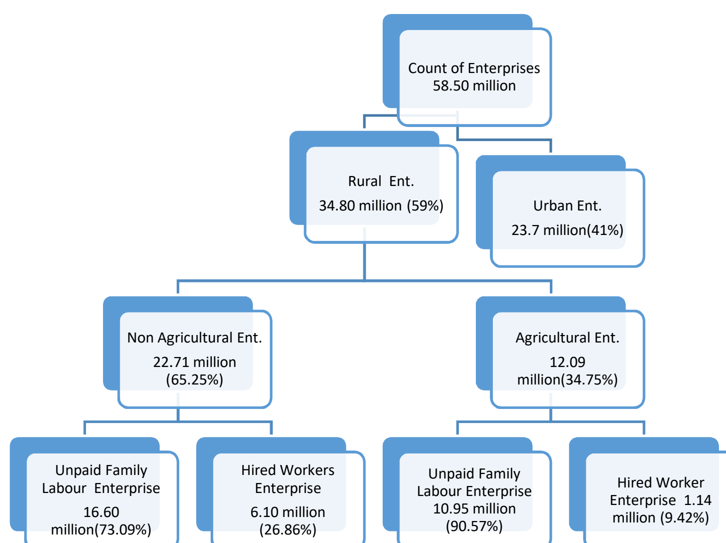


**Figure 1.2: Classification of Rural Enterprises** (Source: Sixth Economic Census)

As per the Sixth Economic Census (2015), the non- farm enterprises provide job to around 46.82 million people in rural areas. The rural non-farm employment increased by 11.86% during the period 2005-2015 which establishes the fact that the sector can be a potential future employer thus reducing the over-dependency on farm employment **(Table1.4)**. During the same period the number

of rural non-farm establishments also grew by 14.53%. The RNF sector is gradually elevating itself to a prominent role in developing the hinterlands of the country. Specifically, as the share of agriculture in adding value to the total economy falls the RNFS will become major provider of jobs and income to the villagers. It should be noted, however, that RNF Employment is not a replacement for jobs in agriculture but rather it is an add-on avenue for employment. Agricultural development cannot be neglected and should be sought after as a necessary precondition for developing the Non- Farm Sector. The promotion of RNF Enterprises also should be undertaken within the broader context of rural development.

**Table 1.4:** Rural Non-Agriculture Establishment and Employment

| | Rural Non-Agriculture Establishment and Employment | | | |
|---|---|---|---|---|
| **Year** | **Own Account** | | **Hired Workers** | |
| | No. of Establishment (Million) | Employment (Million) | No. of Establishment (Million) | Employment (Million) |
| 2015 | 16.60 | 21.65 | 6.10 | 25.17 |
| 2005 | 13.26 | 17.3 | 6.56 | 24.59 |

**Source:** Sixth Economic Census

**The industries which are more prominently located in rural areas may be categorized as:**

- **i.** Agro Based Industry like rice mill, oil mill, sugar factory, dairy units, food processing units
- **ii.** Forest Based Industry like wood products, bamboo products, coir industry, honey,
- **iii.** Mineral based Industry like stone crushing, cement industry etc.
- **iv.** Textile industry like spinning, weaving, coloring, bleaching
- **v.** Engineering and Services like agricultural equipment, tractors and pump set repairs.

**Characteristics of Rural Non-Farm Enterprises**

Most of the non-farm sector enterprises are tiny in nature employing one or two people on an average. Very often they are managed by family members themselves. They normally produce low quality goods and services through manual process. Most of these enterprises are more labor and less capital intensive so entry barrier is low. Many of them are managed by family members without any hired labor.

**Structure of the Rural Non- Farm Sector**

The RNFS can be classified into different sub sectors, consisting of diverse set of activities, in terms of income and productivity level. It can be classified into three groups:

- **i.** The first group comprises of such enterprises which have attained a degree of stability in terms of growth and profitability and employ more of technically skilled labour.
- **ii.** The second group comprises of businesses which employ workers with low skills and low earnings and there is widespread market for supply of labour.
- **iii.** The third group comprises of activities which are seasonal or occasional in nature managed completely through unpaid family labour. They use traditional technology and the production is limited to the local market demand.

**Need for Rural Enterprises**

The growth and development of rural enterprises is required to achieve the following goals:

i. Employment Growth – Employment growth in the farm sector has not been in consonance with employment growth in general. Rural Enterprises provide alternate avenue for employment to the rural youth especially when farm employment has dwindled over the years. Rural enterprises are labour intensive so they have the ability to provide solution to the growing unemployment problem by using the local natural resources and human resources. The rural non- farm sector provides supplementary employment to small, marginal and landless farm households especially during lean season. Many agricultural households take up non- farm activities to augment their income. During crop failure, Non-Farm Sector plays a crucial role in providing income to rural households especially the marginal and small farmers.
ii. Curb Migration – By providing employment, the rural enterprises check the migration of rural youths from villages to cities in search of jobs thus reducing the load on urban infrastructure.
iii. Career Growth – They provide avenue for educated youths in rural areas to start a career in case they do not want to join the farm activities.
iv. Income Growth- Growth in employment will help rural masses to increase the per capita income. The rural urban economic disparity will reduce if the village economy becomes broad based encompassing farm and non- farm activities. It would have beneficial effect in improving the rural income levels.
v. Choice of Products and Services- They increase the availability of large number of product and services in rural areas.
vi. Reduce Income Disparity- Rural income disparity will reduce when opportunities for non-farm employment exists because the lower classes are intensely involved in those activities though they are less lucrative.
vii. Low Entry Barrier- Rural industries, being less capital intensive, are easy to establish and risk involved is less.
viii. Rural industrialization–Growth of rural non-farm sector will have positive impact on agricultural growth. Agriculture and non–agricultural sector of rural economy is mutually dependent. Growth of agriculture boosts the growth prospects of the Non-Farm Sector because they get more raw materials at optimal costs for processing. Further, increased income of farm sector enhances the ability to purchase goods and services from non- farm sector.
ix. Culture of Entrepreneurship- The rural enterprises creates an urge for self-employment among the rural youth.

**Opportunities for Rural Enterprises**

i. Low Establishment Costs-Establishing business in rural areas, costs less compared to urban areas because cost of factors of production is less.
ii. Availability of labor- The rural population is higher compared to urban population. Most of the rural population is employed in agriculture. Agriculture work is available only for few months in a year so rural enterprise enjoys the advantage of unskilled and semi-skilled labor.
iii. Government Policies and Subsidies- The Government of India has announced several schemes for financing rural enterprises and many schemes are highly subsidized.

iv. Availability of raw materials- Most rural industries are agro-based so raw material is locally available which saves transportation and storage costs.
v. Low Cost of Production – In rural areas the factors of production are cheap so overall cost of production is low.
vi. Employment generation for rural youths – Rural enterprises provide jobs to rural masses and if this activity succeeds, problem of migration to towns and cities would get resolved.
vii. Abundance of Customers –Rural population is higher compared to urban population so the availability of potential customers is high in rural areas. This is one reason why the fast-moving consumer goods companies put in so many efforts to capture the rural market.

**Challenges Faced by Rural Enterprises**

i. Lack of Infrastructure -The rural markets have inadequate and poor infrastructure facilities.
ii. Risk Element – Rural enterprises thrive on small capital base so their ability to bear risk is low.
iii. Marketing Problems-The rural enterprises face intense competition from urban enterprises and large sized organizations. Also, the rural enterprises have limited resources so they cannot spend more on sales promotion. The rural enterprises do not sell their product under any brand name so there is no distinct identity for their product. Producers are also scattered and uneducated so they do not have collective approach for marketing their products.
iv. Lack of storage and warehousing facilities-Rural enterprises do not have resources to build storage facilities where they can store the raw material as well as finished products. This often leads to losses due to spoilage and degradation. The business owner sells the product at distress rate because they are unable to store the product and wait for better price to sell them.
v. Lack of Transport and Distribution Facilities-The all-weather rural roads are very few so transport facilities are limited which restricts the distribution of products to nearby areas only while the vast market in far off areas remain untapped.
vi. Lack of Education-This is one of the basic roadblocks for developing rural entrepreneurship because basic education is necessary to acquire the technical and conceptual abilities.
vii. Lack of Market Infrastructure -The rural markets are few in number and they have inadequate and poor infrastructure facilities.
viii. Risk Element – Rural enterprises thrive on small capital base so their ability to bear risk is low.
ix. Lack of Transport and Distribution Facilities- The all-weather rural roads are very few so transport facilities are limited which restricts the distribution of products to nearby areas only while the vast market in far off areas remains untapped.
x. Lack of Education-This is one of the basic roadblocks for developing rural entrepreneurship because basic education is necessary to acquire the technical and conceptual abilities.

**Steps Required for Developing Rural Entrepreneurship**

i. **I**ncrease availability of Credit through soft loans with flexible terms and conditions
ii. Provide skill training to develop competencies
iii. Provide Infrastructure facilities like warehouses, all weather roads, telecommunication system, education facilities, skill development centers, electricity etc.
iv. Strengthen the availability of raw material in rural areas.

v. Strengthen the marketing network
vi. Disseminate information about the facilities available to entrepreneurs for setting up industry in rural areas.

**Government Support to Farm Based Enterprises**

From time to time the Government of India has devised different schemes to boost the agro industry sector. Such Agro Industries help the farmers with access to inputs required for farming and also for marketing of the produce. Brief features of such schemes are mentioned below:

i. The Government of India in collaboration with the State Governments, in 1964 initiated the process of setting up State Agro Industries Corporations (SAICs) which would provide support to the farmers in accessing industrial inputs required for farming. Thus, 17 SAICs were established in the joint sector with share- holding of the Government of India and the respective State. SAICs are now manufacturing and marketing agricultural inputs, agro-equipment and providing after-sales service to agro-based units/industries.
ii. The Government of India also formulated the draft model of "Contract Farming & Services (Promotion & Facilitation) Act, 2018 "to establish a conducive legal framework to integrate the fruit and vegetable farmers to the Agro Industries. This would mitigate the price fluctuation, reduce spoilage and wastage and increase rural employment. The draft has been circulated to the states for implementing it by converting it into an act.
iii. The Government also provides Venture Capital Assistance for Agri-business development. This scheme is executed by the Small Farmers Agri-Business Consortium. The scheme provides loan to agricultural entrepreneurs which is 26 percent of the promoter's capital but not exceeding Rs 50 lakhs. Such assistance to Agri-Business entrepreneurs would not only benefit the farmers but also generate rural employment.

iv. The Agri-Clinics and Agri-Business Centres is another scheme of the Central Government which is there since April 2002. The scheme provides training to unemployed candidates having degree or diploma in Agriculture or those who have completed Intermediate in Agriculture. The National Institute of Agricultural Extension Management is the apex training body which has identified various Nodal Training Institutes in various parts of the country for training. NABARD provides subsidy support for the training and credit support to the agribusiness entrepreneurs through commercial banks. The credit linked subsidy is available for individual loan up to Rs 20 lakhs and group project loan up to Rs 100 lacs for a group of five trained candidates. The subsidy amounts to 36% of total capital outlay for general candidates and 44% for women and scheduled caste candidate.

**Government Support to Non-Farm Based Enterprises**

The Government of India, State Governments and Financial institutions have introduced large number of schemes over the years either individually or jointly to diversify the rural population into Non -Farm Activities so that they have alternate sources of livelihood and income. The effort is to reduce the burden of employment on agriculture whose value addition to the Indian Economy has been declining over the years. Alternate source of income would curb the migration of small and marginal farmers and landless laborers to urban areas. Few such schemes are mentioned below:

i. **Deendayal Upadhyay Gramin Kaushal Vikas Yojana** – This scheme is meant to develop the skill and productive capacity of rural youth from poor families. It is implemented by the Ministry of Rural Development. It provides fund for training the poor youth from rural areas with focus on job placement.

ii. **Deendayal Antodaya Yojana-NRLM** – This scheme aims at setting up sustainable community-based institutions for poor to provide them livelihood with stable income and access to financial services and pull them out of poverty.

iii. **Pradhan Mantri Mudra Yojana** –This scheme aims at providing loans to small and micro enterprises without any collateral. These loans are disbursed through banks, micro-finance institutions and Non- Banking financial Companies for setting up enterprise in non-agricultural sector or for expansion of an existing enterprise.

iv. **Mahatma Gandhi National Rural Employment Generation Programme**- This scheme started in 2005 with the aim to provide employment to rural masses during the lean season when farm employment is not available. The scheme provides 100 days of wage employment in a financial year to members of rural household who are interested in doing unskilled work.

v. **Ajeevika Grameen Express Yojana-** This is a sub-scheme of Deendayal Antodaya Yojana-NRLM. Under this scheme the SHGs can operate transport vehicle in rural areas for providing connectivity between the villages. It is a source of earning for the SHG. The vehicle is purchased by utilizing the community investment funds available with the SHG and it is owned by the SHG. One of the members of SHG operates the vehicle and provide lease rental on a monthly basis. The lease rental covers the operating expense and cost of vehicle over a period of six years. Interest need not be paid while recovering the cost through lease rental. Another alternative method is that the SHG gives loan to one of its members who purchases the vehicle and repays the loan with interest on monthly basis for a period of six years.

vi. **National Bank for Agriculture and Rural Development**– NABARD provides financial support in the form of grant to enable artisans to market their product and realize better prices. It also arranges exhibition and melas which provides a platform for rural producers to showcase their product in urban areas. The village artisans can display and sell their product in urban markets without help of middlemen. NABARD also promotes 'rural hats' and rural marts through grant assistance whereby rural producers can sell their produce in nearby markets. NABARD also supports RSETIs to provide entrepreneurship development and skill training to unemployed rural youth. It also partners with National Skill Development Corporation affiliated training institutes to impart skill training in different segments of society.

The declining share of income from agriculture doesn't mean a decline in importance of agriculture in overall economic development. Agriculture provides food security to the population of the country and employment to more than 50 percent of the population. Agriculture provides support to industry and service sector by providing supply of food and inputs and market for their products. Agriculture provides raw material for number of industries – food- processing, tobacco, packaging, textiles, leather etc.

Majority of the country's populace stays in villages so without development of villages the country cannot develop. Development of rural areas is also critical because without a diversified rural

economy rural population migrate to urban areas for livelihood which creates pressure on urban infrastructure. Rural population provides a huge market for -the fast-moving consumer goods industry, beverages, banking industry and other sectors of the economy. Rural population need alternate sources of income because in many regions of the country only one crop is taken during the monsoon season and cultivators and farm labors remain idle during other season and seek avenues for livelihood. Rural Non-Farm Enterprises hold the potential to provide major employment to rural population in future.

The present Government intends to double the farmers' income by 2022. The committee entrusted with the job of identifying avenues for growth in Farmer's income has suggested the following potential growth areas:

- **i.** Increase the productivity of Crop and livestock
- **ii.** Efficiency of usage of resource for reduction of Cost
- **iii.** Increase the no. of crops grown in the same field during the agriculture year
- **iv.** Shift to crops which provide better value
- **v.** Increase the remuneration received by farmers by selling the produce
- **vi.** Promote Non- Farm occupation to reduce the dependence on agriculture for employment

Government has shifted its focus from setting production targets to laying emphasis on increasing farm income. The income approach is based on increasing productivity, lowering the costs of cultivation and getting remunerative prices for the produce so that farming becomes profitable. The policy focus has shifted from technical aspects of agricultural production to the income generation and profitability of farmers.

## 1.2. Importance of Finance as Scarce Resources

Finance is defined as the art or science of managing money and includes activities such as investing, borrowing, lending, budgeting, saving, and forecasting. A broad-based definition of finance refers to it as an administrative area or a group of administrative functions. The concept of finance is somewhat broadened by defining finance as the administrative department or a group of administrative functions in an organisation which deals with managing liquidity so that there is sufficient cash to carry out its regular activities and meet the commitments as they become due.

**Importance of Finance for Household**

India is a developing country where 29.5 percent of the population survive below the subsistence level. They are mostly employed in farm sector in rural areas and in various industries like textile, construction, manufacturing etc. in semi-urban and urban areas. Thirty four percent of the country's population is also illiterate and mostly unskilled. Poverty, Illiteracy and lack of skills restrict them from leveraging their capability to increase income and save some money for future. In the absence of savings, they can neither afford to enhance their skills nor can they afford to buy assets to increase the productivity and income. Low income and inadequate savings leave very little scope for capital formation and investment required to unshackle the vicious cycle of poverty. In other words, the poor households can overcome poverty only when they have adequate capital which they can invest to augment their income.

Access to affordable source of finance when required enables the households to get the much-needed capital for investment and income generation. On the contrary, non- availability of finance at the time of distress causes them to slip into further poverty. An economic system which realizes the need for small amount of finance to the poor and makes provision for the same can only pull people out of the poverty cycle. A little infusion of capital can also be used for better education and acquiring higher skill which also enhances the income and improves their standard of living. Financial services are required by households to cater to different livelihood needs like smoothening the cash flow, coping with shocks (e.g., health problem or disaster), Asset creation for Income generation and planning for future (life cycle needs, big ticket purchases).

**Importance of Finance for Businesses**

A business has to make expenses before it generates revenues. Any Businessman looking forward to set up a new business or expand his existing business requires investing money expecting to earn revenues in future. He can make the investment from his own sources but since that is not sufficient; he may have to borrow from external sources like the money market or the capital market. The need for finance is more acute for small businesses who have very little of their own capital funds. They operate on low a margin which constrains them from generating internal funds for investment. They are also easily vulnerable to shocks and disruption.

**The reason why businessmen require money may be broadly summed up as follows:**

- **i.** To start a business -Availability of finance promotes entrepreneurship. Entrepreneurs need money to transform their ideas into profitable venture, thus providing employment to many and support to other businesses. New entrepreneurs with new ideas dismantle the older ones having outdated technologies and thus enabling a constant improvement of quality and productivity.
- **ii.** To operate a business – Business operations require physical assets and consumables without which production of goods cannot happen. To purchase these resources finance is necessary. The company should not face financial constraints for making payment to its creditors, disbursing salary to its employees or paying interest on loans etc. In case the company faces such problem, it won’t be able to run the business and survive in the market. Thus, finance enables a business to operate smoothly without running out of cash.
- **iii.** To manage cash flows -Organisations having surplus fund need avenues to invest so that they can earn income which can be utilised for future expansion plans or for new ventures in long run.
- **iv.** To achieve long term goals- Businesses need finance to remain competitive in the market through constant research and innovation. They continuously strive to achieve growth and scale up their business in the long run through geographical expansion and capacity enhancement which requires huge sum of money that may not be available internally.
- **v.** To sustain economic downturn-Organisations do not keep growing on a continuous basis. Recession, depression, boom and failures all add up to fall in business volumes. With significant amount of finance, it becomes easier for the organisation to manage the trends of business cycle.
- **vi.** To do advertising and marketing – Businesses have become highly competitive so in order to survive and gain more and more market share they have to advertise and promote their

products. This is more applicable for new businesses which need to make the prospective users aware about their product and services so that they start buying them and experience their benefits in future.

**Importance of Finance for a Nation**

Finance is the fuel for economic growth of a nation. The ease of availability of finance encourage businesses to expand, innovate and grow, generating more and more opportunities for employment and causing other businesses to grow. It enables the households to fulfil their need for consumption as well as for capacity enhancement and skill up- gradation for better income and improved standard of living. An organised financial system within the country is a pre-requisite for economic growth just like a functional legal and regulatory system. It encourages savings and investment and links the savers and investors for creation of wealth. It facilitates the deepening and broadening of financial market and efficient allocation of resources.

Financial system may be defined as a system which covers financial markets, financial institutions and financial services that connect the depositors with investors. They cater to the short-term and long-term fund requirement of businesses as well as households. The system that facilitates the movement of finance from the persons who have surplus funds to the persons who need it is called as financial system. Business and households both need funds and the effectiveness of a financial system is determined by the ease with which they can raise the fund. The efficiency of the financial system has a positive impact on the economic growth of the country. For instance, a nation having a robust payment network makes it easy for agents to trade and thus impact the economic growth. Efficient financial system can direct the savings in a manner by which they get invested efficiently. If firms in a country cannot or do not invest in valuable projects compared to firms in another country, the country with more efficient investment is the one that grows more. **Figure 1.3** gives an overview of the financial system in India.

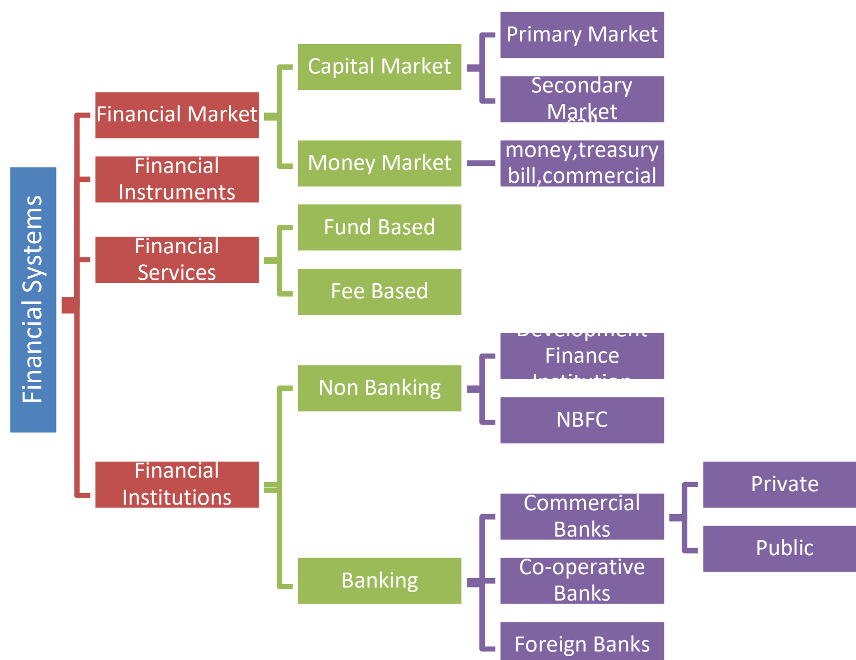


**Figure 1.3:** Financial Systems in India

Researchers trying to study the linkage between financial system and economic growth are convinced that countries where the financial systems are developed generally have a faster growth rate primarily because there are:

i. Banks which channelize household deposit to private enterprises in the form of credit and
ii. Capital market which generates liquidity in the system.

**Advantages of a Developed Financial System**

A developed functional financial system is a major driver of economic growth because:

i. It eases the constraints associated with external financing that impede expansion of firm and industries. It allows financially constrained firms to expand and increase their productivity.
ii. It encourages entrepreneurs to experiment with their ideas and bring them to reality. A vibrant financial ecosystem triggers innovation and imagination of the visionary entrepreneur.
iii. It increases the volume as well as rate of savings because of the availability of various financial instruments and facilitates for ease of mobilisation of savings.
iv. It protects the interest of investors through regulatory mechanisms and issuing advisory services for better investment decisions.
v. It increases the national output of the country by providing funds to businesses to scale up their production which further increases employment and raises the standard of living of the people. It triggers overall growth of the economy.
vi. It helps in increasing the financial assets as percentage of GDP and also broadening and deepening the financial reach. Thus, there is an overall increase in the number of participants in the financial system.
vii. It enhances the financial literacy through constant campaigns for achieving the goal of financial inclusion.

Ease of availability of finance in an economy increases the risk-taking ability due to two reasons. Firstly, it increases the earnings which enables business firms to experiment with activities which involves chances of incurring larger losses. Secondly a more developed economy provides businesses with better risk-mitigating and risk-transfer mechanisms than those available in poor economy.

Access to finance is thus considered as a precursor to economic growth. When opportunity to access finance is available, then investment happens which marks the commencement of industrial growth. It initiates the path towards economic development by encouraging those who are constrained due to scarcity of capital and motivates them to take the risk of experimenting with new ideas.

**Components of the Financial System**

The components of a financial system comprise of four elements:

i. **Financial Institutions** – These are intermediaries in the financial system which collect money from individuals and invests that money in financial assets like loans, bonds, stocks etc. These can be either Banking or Non- Banking institutions. Banking institutions collect deposit from customers and use it to advance loans to those who need it. Non- Banking Institutions cannot collect money deposits but can sell financial products to customer. They may be brokerage firms, insurance companies or non-banking finance companies selling different

types of financial products. Financial intermediaries help in optimal distribution of resources by mobilising savings and providing them to business entrepreneurs who need money for investment.

ii. **Financial Markets -** Financial markets are places where buyers and sellers participate in trading of various types of financial instruments like shares, bonds, short term money market instruments etc. It comprises of i) capital market and ii) money market. Capital markets deals with long term securities with maturity period exceeding 12 months while money market deals with trading of short-term debt instruments having maturity of less than one year. Transferring domestic savings to Capital Market and Money market ensures healthy growth in investment and prosperity of business. These channels steer the domestic savings and provides them to entrepreneurs who utilise it for developing their business and hence they are necessary for economic development.

iii. **Financial assets or Instruments-** These include cash deposits, cheques, loans, letter of credit, bank notes and other instruments which can be purchased. They raise a claim against a financial institution to pay a specific sum of money on demand or on a specific future date or to pay the principal along with interest.

iv. **Financial Services-**The financial services are concerned with the design and delivery of financial instruments and issuing advisory services to individuals and businesses on financial planning, investments, assets, insurance etc.

**Various Sources of Raising Finance**

Funds can be generated from within the organisation or from outside. Figure 1.4 describes the different sources for raising fund. Funds that originate from business are classified as internal sources of fund like profit retained back in business, speedy disposal of excess stock or quick recovery of money owed by debtors. Some of the prominent internal sources for finance are mentioned below:

i. **Savings of individuals:** Savings by individuals are invested either in bank account or in other savings instruments like shares, mutual funds, bonds etc. which are then borrowed by businesses for growth and investment.

ii. **Retained profits:** These are the profits which are not distributed to the provider of capital but retained in business for further growth. They are funds with least cost compared to funds raised through debt or fresh equity and since they are generated internally there is no attached conditions for usage.

iii. **Depreciation and obsolescence reserves:** In order to replace the assets which, become obsolete due to wear and tear or outdated technology, businesses normally set up a reserve fund. Such reserves are used to replace the existing asset with new asset.

iv. **Trade Credits:** When a purchaser buys goods and services, he has the option to pay immediately or defer the payment. The latter is known as trade credit. Trade credit gives an opportunity to the promoter of business to utilise the fund for a longer period till the time he has to pay to the creditor. Trade credit is commonly used by business organisations as a source of short-term liquidity. Extent of trade credit which the purchaser gets depends upon his market reputation, value of the transaction, past credit record, seller's financial condition etc.

However, there is very little scope of sourcing all fund internally so business organisation depends on outside sources also when they need large quantity of fund. External funds are expensive compared to those originating from internal sources. These are known as the external sources of finance. External sources of finance can be further classified as: **I) Domestic Sources ii) International Sources**. Some of the domestic sources of finance are mentioned below:

i. **Commercial banks Loans-** Banks are the most common source from which the business gets fund to purchase its raw material input as well as fixed assets.
ii. **Shares -** A Company issues share to raise share capital from the investors. The total share capital of a company is the aggregate of small units called shares. Each share has its nominal value, normally Rs 10. The person can apply for shares by paying the value of the number of shares he wants to purchase. The person who owns the share in a company is known as the shareholder of the company.
iii. **Commercial Papers-** It is a source of raising short term funds which was popularised in our country during early nineties. They are in the form of promissory note whereby the fund-raising company promises to pay the fund provider a specified sum on a fixed date. Such funds are not raised by providing any collateral so they are unsecured loans. The commercial paper is issued for a short period, varying from 90 days to 364 days.
iv. **Debentures** – It is a popular instrument for raising long term borrowings from the market. A company which needs fund issues debentures, promising to repay the money on a particular date. Debentures bear a fixed rate of interest.
v. **Public Deposits** Institutions which have investment grade rating are allowed to raise deposits from public which are known as public deposits. Rates of interest usually higher than that offered on bank deposits. The deposit raising organisation issues a receipt in lieu of the deposit amount received.
vi. **Development Finance Institutions-** There are a number of financial organisations which were established by the government to provide loans to businesses. These institutions subscribe to initial capital of companies as well as provide loans for long and medium term. They strengthen the efforts of commercial banks in fulfilling the credit need of business establishments. These institutions were established for specific purpose and they are specialised to provide finance to specified sectors like Small Industries Development Bank of India (SIDBI), Industrial Finance Corporation of India (IFCI) etc. At the state level also, there are State Finance Corporations for lending to industries.

Funds can also be raised from international markets as well. Indian Businesses operating at global level occasionally raise money from International Capital Markets. There are primarily three sources for global fund raising:

1. **Commercial Banks –** Banks across the world provide loan in foreign currency for business purposes. Banks are popular avenue for raising finance by companies involved in non-trade global business.
2. **International agencies and Development Funds-**There are many International Development Finance Institutions and banks which provide funds to businesses operating in different countries. They not only provide long and medium-term loans but also give grants to uplift the economically backward countries across the globe. Some such agencies are International Finance Corporation, International Monetary Fund, Asian Development Bank etc.

3. **International Capital Market –** Modern organisation, especially International Businesses need funds in local as well as international currency which they raise from local as well as Global capital market. Financial Instruments which satisfy these purposes are:

   i. **Global Depository Receipts** – This is an instrument by which a company located in one country can raise foreign currency funds by issuing shares or bonds in another country. The shares of the company are transferred to the depository bank which issues depository receipt against these shares. The shares are listed on the stock exchange of the country where the fund is raised. Depository receipts give the foreign investors an opportunity to hold shares and trade in the equity of other countries. Depository receipts are issued in US Dollars and they are negotiable instruments which can be freely traded on the stock exchange where it is listed.
   ii. **American Depository Receipts-** These are depository receipts issued by depository banks based in USA against shares of non-USA based company. The company is listed in American stock exchange and shares are issued to American citizen and can be traded in American stock market.
   iii. **Indian Depository Receipts** –When foreign companies raise funds from Indian capital market and shares are deposited in Indian depository bank and receipts are issued to the Indian shareholders in Indian rupees, it is called Indian Depository Receipts. It enables a foreign company to raise money in Indian rupees. The foreign company gets listed on Indian stock exchange and the shares can be traded on the exchange.
   iv. **Foreign Currency Convertible Bonds -** Foreign currency convertible bonds are bonds which are issued in a currency other than the home currency of the issuer of the bond. The money is raised by a company in the form of foreign currency. Companies which want expand in foreign markets use the FCCB route to raise money. FCCB bonds are a mix of debt and equity. The bondholder has the option to convert the bond into equity at specified rate or at rates prevailing in the stock exchange, after a specified period of time. The FCCB's are issued in a foreign currency and their rate of interest is fixed and also less than the rate of other similar nonconvertible debt instrument. FCCB's are listed and traded in foreign stock exchanges.

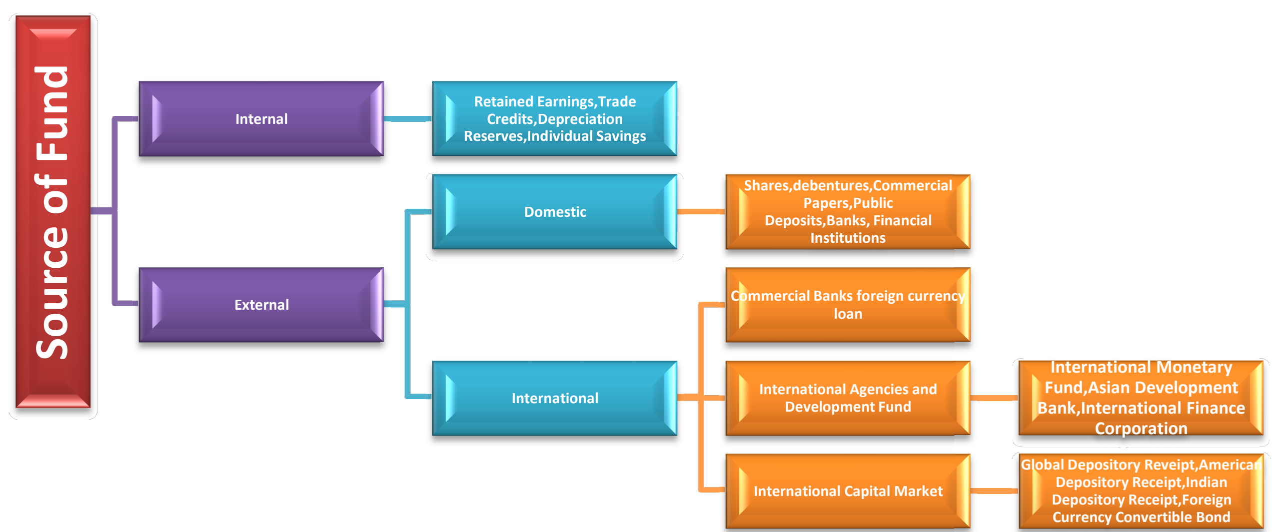


**Figure: 1.4:** Various Sources for Raising Finance

**Factors Affecting the Choice of Finance**

Businesses scrutinize various factors before deciding on the source of finance. Each source of finance has its own merits and demerits and hence it is prudent for businesses not to depend on only one source but on a combination of sources to have a balanced fund situation. Some of the factors effecting the combination of sources of finance are:

i. **Cost –** The cost of finance has direct implication on the in-net flow of cash in future and profitability and the capacity to repay. The expected profitability has to be higher than the investor's cost of capital. Parameters which influence the cost of finance are tenor of financing, risk exposure, availability of collateral, forecasted inflation rates and tax rate. Traditionally the rate for short term finance is lesser than long term since in the former case there is expectation of early liquidity. Cost of finance also reduces if it is secured by pledge of collateral. Similarly, investment in high-risk projects will entail higher cost and vice versa.

ii. The rates at which loan is disbursed must include should factor in the compensation for the expected inflation when the loan is finally repaid

iii. **Financial Stability -** The robustness of business is also a key determinant in the choice of finance. The business has to be in a strong financial position to be able to repay the borrowed amount with interest. If the earnings are not stable funds with fixed charge like preference shares and debentures should be carefully selected as they increase the financial burden of the organisation.

iv. **Legal Structure of the organisation** - Certain forms of funding are related to the legal status of the organisation so they are not available to other forms of organisation. The proprietary or partnership firms cannot raise finance by issue of shares. They are available only to joint stock companies.

v. **Flexibility –** Selecting the source of finance also depends on how effortlessly the fund is obtained. Restrictive clauses, detailed investigation and excessive documentation in case of borrowings from banks and financial institutions for example may be the reason that a business organisation may not prefer it, if other options are readily available.

vi. **Accessibility –**This is a problem, not with large business houses but with the micro and small-scale industries who find it difficult to get money at cheaper rates because they are considered more risky.

vii. **Control -** The selection of source of finance will also depends on the extent of control the borrower is willing to forego. The borrower has to decide between retaining control or diluting control while finalising the terms of agreement with the lender.

viii. **Tax Benefits -** Organisation may weigh the sources of finance in terms of their tax benefits. For example, while the dividend on preference shares is not tax-deductible interest on loans and debentures is tax deductible so they may be preferred by organisations seeking tax benefits. Effective Cost of finance reduces for the borrower if there is an interest component to be paid because the interest is chargeable against the profit thus reducing the tax outflow.

ix. **Risk profile -** Before deciding the source, businesses have to estimate the risk involved in case of different sources. Normally raising fund by issuing shares is less risky compared to loans because in the former case dividend need not be paid in case there is no profit whereas for the latter repayment is necessary irrespective of profit or loss.

**Various Methods of Classifying Finance**

Finance can be classified based on the following parameters:

1. **Tenor of finance**
2. **Nature of ownership**

On the basis of tenor, finance can be classified in three parts:

i. **Long term Finance–** Businesses have to invest in assets like land, building, machinery etc. which normally have a long life in terms of utility. The amount of finance required is large and their period of repayment generally exceeds five years. The assets which are purchased by long term finance are also called fixed assets because their value reduces slowly and they cannot be immediately transformed into cash.
ii. **Medium Term finance** – This relates to funds which are borrowed for a period exceeding one year but not more than five years. Such finance can be availed from commercial banks, financial institutions or by collecting deposits from public.
iii. **Short term finance** is mainly availed for meeting the working capital requirement of business such as purchase of raw materials, payment of wages and salary of staff, rent etc. Such finance mainly supports in meeting the requirement of funds for day-to-day activities. It is in liquid or near liquid form so it can be promptly converted into cash hence it is also termed as liquid capital. Short-term finances are repaid within one year.

On the basis of ownership generation, a business may have two types of fund – one that is brought by owners of the business and the other which is borrowed from outsiders. The owner of the business can be a sole proprietor or partner or shareholders depending upon the legal structure of the business. Owners bring in capital to start business. They may also reinvest the profit in full or part, in the business. Such contribution by the owner /promoter represents their authority and stake in the business. Since the fund belongs to the owner it remains invested for long term unlike borrowed fund which needs to be returned. However, the ownership may be transferred by sale and purchase of shareholdings in the business.

Borrowed funds', as the name suggests, is the fund raised by taking loans at a specific rate of interest, for a specified period, with specified terms and conditions and for a fixed tenure and it needs to be repaid on or before the date of expiry. Such funds can be in the form of borrowings from commercial banks or from financial institutions or by issuing instruments like debentures and bonds, raising public deposits or by availing trade credits. If the fund is borrowed against some fixed asset as security it is called secured loan, otherwise it is called unsecured.

**Importance of Finance**

Undoubtedly finance is one of the key resources for growth of the economy. Access to finance helps industries to embark into expansion to increase the output, which adds to overall output of the economy and causes growth. In this process of growth, it also provides employment to many and business opportunity to another organisation. At the individual level having access to finance leads them to acquire better education and skill which helps them to gain better income. Households need finance to fulfil their need for consumption, purchase assets, manage shocks and make big ticket purchases.

### 1.3 Need for Financing Rural Economy

Rural Economy needs finance for various reasons. People are poor so they need credit for consumption purpose. Thirty Seven percent people in rural areas live below the poverty line. Their main occupation is agriculture and in every crop season they require working capital for purchasing seeds, fertilizers, pesticides, irrigation etc. Besides, they also need money for long term investment

in assets to boost agriculture productivity e.g. Livestock, motor pump, and tractor. Rural economy is predominantly dependent on agriculture. The agriculture is mostly rain fed so there are frequent instances of crop failure due to inadequate rainfall and, subsequent loss of income, making the cultivators more dependent on finance from either institutional or non-institutional sources. Rural households are vulnerable to shocks with respect to income and expenditure and need credit as an insurance against risk.

Also, in rain fed areas crop is mostly sown once a year so during the remaining period farmers do not have any source of income and hence, they require financial support as a supplementary measure. These include support for food, housing, health and education. Crop failure may not be the only reason for the farmers to borrow. In the absence of storage facilities crop surplus can also send the market price crashing down and the farmer goes for distress sale where he is unable to recover even the cost of production.

The social network in rural areas is very close knit and they believe in fulfilling social responsibilities even with their meagre income. So, meeting expenses for social and religious ceremony is another area where the rural population likes to spend despite not having adequate income e.g., marriage, child birth ceremony etc. Such expenses are perceived to uplift their honour within the community. Often loan is taken, not for productive purpose but for consumption or for meeting expenses towards social and religious ceremonies.

In many cases interest becomes a heavy liability for the household, if the loan is borrowed from non-institutional sources like money-lenders, at very high rate of interest and they slip into further poverty. The need, nature, causes and magnitude of rural indebtedness have a significant bearing upon the purpose of borrowing and ultimate use borrowed funds by rural families, relationship between debtors and creditors, prevailing system of agrarian and socio-economic reform and ownership structure and governance of credit institutions operating in rural areas.

The poor rural households find it easier to approach the moneylender because the document required is very less and there is no demand for collateral. The lending process is also very flexible and prompt unlike the institutional lending system. The institutional lenders do not favour giving loan for consumption though that is most sought after by rural household in order to cope up with the loss of income during lean season or during crop failure. The moneylender is not only willing to provide loan for this purpose but also his terms and condition are flexible enough depending upon his personal assessment of the borrower. Focus of all financial endeavours is to build up large sum of money which can help to meet various requirements. The difficulty is to accumulate such large sum when the income is low and saving is uncertain.

**Options Available for meeting the financial Requirement**

The rural population uses various methods to address the lump sum requirement of money. None of this method is exclusive but a combination of methods is used. Such methods may be classified as:

**i.** Savings Up – This refers to cutting down on present consumption to save for future. Poor people in rural areas keep money in hidden location at home or even in bank to provide for future needs.

ii. Savings Down – This refers to cutting down on future consumption for current liquidity. Poor people take loan from institutional and non- institutional sources to meet their immediate financial needs, which they repay by reducing the future consumption. Savings Down also means taking a loan

iii. Savings Through- This refers to regular saving of a small amount of money by contributing to Self Help Groups thus generating a lump sum amount which is lent to members of the group on chargeable basis e.g., recurring deposits.

iv. Migration & Remittances – People from rural areas migrate to urban areas and metros in search of livelihood and they send a portion of their earnings to their family in the village. Remittances are a prominent source of finance for the rural population.

v. Distress sale of Assets- People often sell their assets like cows or poultry or land to meet the requirement of money in distress situation.

vi. Diversification-Most of the members in rural household are involved in different activities for income purpose. Such diversified employment helps the household to withstand income losses due to crop failure or any other vulnerability.

vii. Creation of Social Capital – The poor people are closely connected with their friends and relatives so that they can support each other during difficult times. Mutual support helps them to cope up with requirement of money during distress.

viii. Social Assistance Entitlement –In many countries Government does re-allocation of income and wealth by making payment without goods or services in return. Such social transfers include welfare programs, subsidies, social security measures, aids etc. Unemployment benefits, widow pension, food subsidy etc. falls under social assistance.

ix. Insurance – Crop and livestock insurance are provided by Government at subsidized premium which helps them to sustain the crop losses or losses due to death of livestock. Health and live covers also help to cover the risk of loss of livelihood due to debilitation or death.

**Sources of Credit**

In the "Savings Down" category the rural households have options to take loan from Institutional or Non-Institutional sources (moneylenders). The credit requirement is mostly met by the local moneylender who gives loan instantly with minimal documents. However, the rate of interest is very high which the farmer finds difficult to repay. Nowadays the input supplier and Landowner (in case of tenant farmers) also double up as moneylender.

In case there is crop failure due to drought or flood or pest infection or any other reason the farmer fails to repay the debt and loses his piece of agricultural land which he mortgaged to the moneylender. The moneylender thus succeeds in limiting the freedom to take loan from institutional sources. Even in case of surplus production farmer may not get remunerative prices due to glut in supply and resort to distress sale. In such a case he fails to repay the debt to the moneylender and falls in debt trap. The farmer neither has the surplus money to avoid distress sale and nor access to storage facility where he can store the produce till, he gets a better price.

The institutional sources of finance lack the flexibility and the agility of the non-institutional sources to provide timely and adequate loan. They are also uncomfortable lending to farmers because of the high risk and heavy expenses involved in operating in rural locations. The financing institutions

restrict loans for productive purpose only so the farmers have no choice but to go for non-institutional credit for consumption purpose. The farmers are also unable to meet the documentation required by the institutions for financing purpose. Survey by NAFIS in 2016 showed that 32 percent of rural household still avail non-institutional sourced of credit (Figure 1.5)

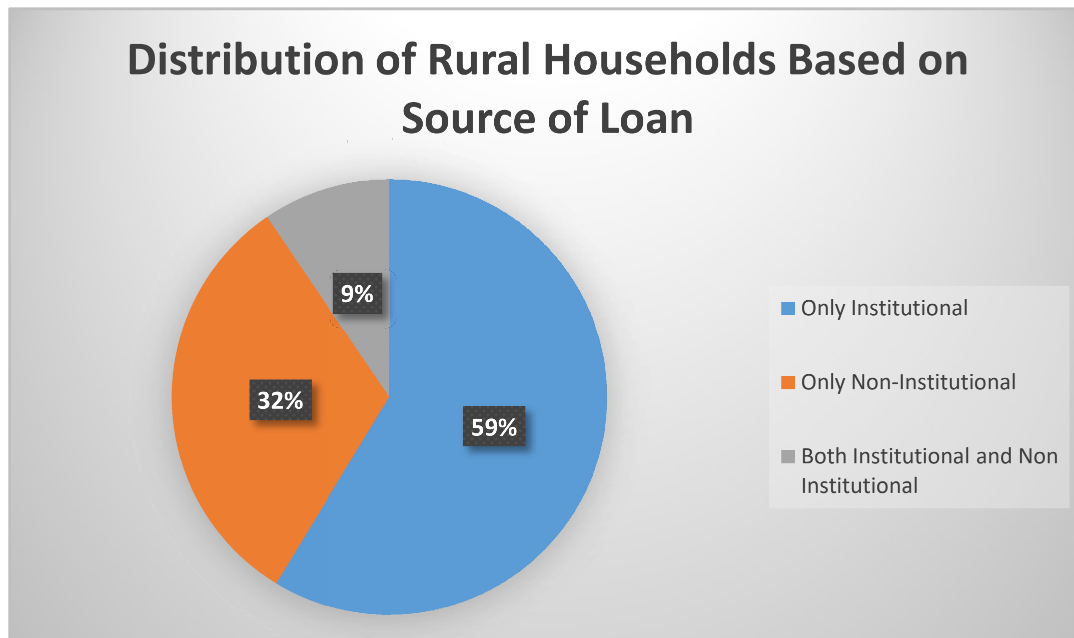


**Figure 1.5** Distribution of Rural Households Based on Source of Loan **|** ***Source:*** *NAFIS Survey-2017*

**Progress of Institutional Credit Delivery in Rural Areas**

In Pre-Independence era, the Co-operative Banks were the main drivers of credit in rural areas. After Independence, ensuring food security was one of the prime goals of the Government. Green Revolution initiatives had just started in the country and to achieve its full potential, access to technology and inputs were necessary. The farmers were poor; they needed credit support from banks to reap the benefits of Green Revolution. The Co-operatives were in poor financial condition. The All-India Rural Credit Survey report (1951), in its report highlighted that the co-operatives do not have adequate resources to fulfill the credit requirement in rural areas. The survey noted that ninety two percent of the credit requirement was met from non- institutional sources. The private banks were not interested in rural lending because of the high risk and low returns associated with lending to the poor. They perceived the poor as non-bankable and preferred giving loans to the industry.

To achieve the goal of channelizing credit to rural areas, freeing farmers from the clutches of usurious moneylenders and accomplishing food sufficiency goal, the Government nationalized all the private sector banks in 1969, by Banking Companies (Acquisition and Transfer of Undertakings) Ordinance. It marked the first turning point from Class Banking to Mass Banking. It also marked the commencement of social banking when banks started lending to rural poor through directed credit policy norms.

The banking journey from 1969 primarily focused on opening more and more banks in remote locations and directing the credit flows to rural masses through various schemes like the Priority Sector Lending and the Lead Bank Scheme. The policy of lending to Priority Sector directed the banks to lend forty percent of the total credit to farm sector. Under the lead bank scheme, 1968, one of the banks in the district was designated as leads bank to co-ordinate the credit delivery efforts of all

banks towards the priority sector. Regional Rural Banks were started in 1975 to bring further attention towards delivery of Rural Credit. In 1981, the National Bank of Agriculture and Rural Development was established to focus on policies related to lending to Agriculture and allied services and for capacity building, promotion of financial literacy and for refinance purpose. The Government thus adopted the directed credit delivery model through multiple agencies – Scheduled Commercial Banks, Co-operative Banks and Regional Rural Banks. There was multi-fold growth in the total count of bank outlets and flow of advances in semi-urban and rural areas (Table 1.5)

**Table1.5:** Number of bank branches by population group

| Number of bank branches by population group | | | | | |
|---|---|---|---|---|---|
| **Period** | **Rural** | **Semi-urban** | **Urban** | **Metropolitan** | **Total** |
| 1969 | 1,833 | 3,342 | 1,584 | 1,503 | 8,262 |
| 1991 | 35,206 | 11,344 | 8,046 | 5,624 | 60,220 |
| 1994 | 35,329 | 11,890 | 8,745 | 5,839 | 61,803 |
| 1995 | 33,004 | 13,341 | 8,868 | 7,154 | 62,367 |
| 2005 | 32,082 | 15,403 | 11,500 | 9,370 | 68,355 |
| 2006 | 30,579 | 15,556 | 12,032 | 11,304 | 69,471 |
| 2007 | 30,551 | 16,361 | 12,970 | 11,957 | 71,839 |
| 2008 | 31,076 | 17,675 | 14,391 | 12,908 | 76,050 |
| 2009 | 29,210 | 19,939 | 15,902 | 18,165 | 83,216 |
| 2010 | 30,107 | 21,664 | 17,478 | 19,637 | 88,886 |
| 2011 | 31,396 | 23,985 | 18,536 | 20,937 | 94,854 |
| 2012 | 33,727 | 26,863 | 19,982 | 22,390 | 1,02,962 |
| 2013 | 36,720 | 29,784 | 21,286 | 23,592 | 1,11,382 |
| 2014 | 41,800 | 32,923 | 22,868 | 25,125 | 1,22,716 |
| 2015 | 45,108 | 35,307 | 24,417 | 26,679 | 1,31,511 |
| 2016 | 48,221 | 38,001 | 26,040 | 28,254 | 1,40,516 |
| 2017 | 49,816 | 39,459 | 27,338 | 29,661 | 1,46,274 |
| 2018 | 50,802 | 40,131 | 27,717 | 29,640 | 1,48,290 |
| 2019 | 51,591 | 41,619 | 28,607 | 30,219 | 1,52,036 |

**Source:** https://dbie.rbi.org.in/DBIE/dbie.rbi

However, the quality of lending deteriorated drastically. Loans were given through loan melas without adequate credit risk appraisal and later waived through mass loan waivers. The beneficiaries were mostly the rural elites who had the capability to fulfill the documentation required by the bank for processing the loan. The financial health of the banks deteriorated due to rising defaults, poor quality assets, corruption and political interference.

In 1990, there was a dire need to relook at the quality of rural banking with focus on profitability of the banks. The year marked a paradigm shift from brick-and-mortar expansion model to expansion through online mode by use of internet connectivity. New Models of rural banking were designed to reach the last mile at least cost – Business Correspondents Model, SHG-Bank Linkages and Microfinance Institutions. The focus was to reduce the cost through business partnership with interested vendors by application of communication technology for the last mile coverage.

In the late 1990's there was a surge in the number of micro-finance institutions which were specialized financial institutions operating in rural areas, giving non collateral based micro loans at slightly higher rates compared to the banks but lower than that offered by moneylenders. Loans below Rs 50000 are classified as micro-loans. The loan was disbursed to joint liability groups where the members of the group decided the distribution amount to the individual members. The loan was

disbursed based on peer-to-peer review and all members were jointly responsible for timely repayment of loan by the group.

In 2016, RBI gave licenses to niche banks like Small Finance Banks and Payment Banks. Many microfinance institutions have converted themselves into Small Finance Banks or have been merged with existing banks for access to public deposits which is source of cheap funds. Micro Finance Institution is not permitted to raise public deposits which are cheap source of fund, while banks can do so. Even after so much impetus on supply of credit in rural areas, the presence of moneylenders is still there. As per All India Debt Investment Survey Report, 2013, 36 percent of household credit in rural areas is attributed to non-institutional sources which are a matter of concern.

## 1.4 Agriculture and Allied Services

Agriculture and allied sectors play a key role in India's rural economy. 70% of the rural households depend on agriculture as a primary source of livelihood. Agriculture employs more than 50% of the national work force **(Table1.6)**.

**Table1.6: Rural Population and Agricultural Workers**

| Year | Total Population | Annual Exponential Growth Rate | Rural Population | Percentage Rural Population | Total Workers | Cultivators | Agriculture Labourers | Total | Percentage of Agricultural workers to total workers |
|---|---|---|---|---|---|---|---|---|---|
| 1951 | 361.1 | 1.25 | 298.6 | 82.7 | 139.5 | 69.9 | 27.3 | 97.2 | 69.7 |
| 1961 | 439.2 | 1.96 | 360.3 | 82.0 | 188.7 | 99.6 | 31.5 | 131.1 | 69.5 |
| 1971 | 548.2 | 2.2 | 439 | 80.1 | 180.4 | 78.2 | 47.5 | 125.7 | 69.7 |
| 1981 | 683.3 | 2.22 | 525.6 | 76.9 | 244.6 | 92.5 | 55.5 | 148 | 60.5 |
| 1991 | 846.4 | 2.16 | 630.6 | 74.5 | 314.1 | 110.7 | 74.6 | 185.3 | 59.0 |
| 2001 | 1028.7 | 1.97 | 742.6 | 72.2 | 402.2 | 127.3 | 106.8 | 234.1 | 58.2 |
| 2011 | 1210.9 | 1.5 | 833.7 | 68.8 | 481.9 | 118.8 | 144.3 | 263.1 | 54.6 |

***Source: Agriculture Statistics at a Glance,2018***

However, despite the huge employment it provides the sector account for only 17.1 percent of Gross Value Added in 2017-18 at current prices and an estimated 16 percent of Gross Value Added at 2018-19 current prices. The contribution of the farm sector in the national GDP has declined over the years while that of manufacturing sector and services sector have increased **(Table 1.7)**. In 1950 the agriculture sector contributed more than 50% of nation's GDP which in 2015-16 reduced to 15.4% at constant prices. Reduced share of agriculture in national Gross Value Product is natural for a rapidly growing economy but the employment did not commensurate with the decline in contribution which is a cause of concern.

**Table1.7:** Sectorial Share in Gross Value Added at Current Prices 2011-12 series

| Particulars | Sectorial Share in Gross Value Added at Current Prices 2011-12 series | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| **Sectors** | **2011-12** | **2012-13** | **2013-14** | **2014-15** | **2015-16** | **2016-17** | **2017-18** | **2018-19** |
| Agriculture, Forestry & Fishing | 18.5 | 18.2 | 18.6 | 18.2 | 17.7 | 17.9 | 17.2 | 16 |
| Industry | 32.5 | 31.8 | 30.8 | 30 | 29.8 | 29.3 | 29.3 | 29.8 |
| Services | 49 | 50 | 50.6 | 51.8 | 52.5 | 52.8 | 53.5 | 54.2 |
| Total | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |

***Source: Agriculture Statistics at a Glance, 2018***

Year on Year agricultural growth has been unstable during the last five years, varying from 1.5 percent during 2012-13 to -0.2% during 2014-15 and 5% during 2017-18 **(Table 1.8)**. Such variance in agriculture growth causes fluctuation in farm incomes, increases the risk and effects farmers' ability to get bank credits.

**Table1.8:** Growth in GVA at constant (2011-12) prices

| Growth in GVA at constant (2011-12) prices | | | | | | | |
|---|---|---|---|---|---|---|---|
| **Sectors** | **2012-13** | **2013-14** | **2014-15** | **2015-16** | **2016-17** | **2017-18** | **2018-19** |
| Agriculture, Forestry & Fishing | 1.5 | 5.6 | -0.2 | 0.6 | 6.3 | 5 | 2.7 |
| Industry | 3.3 | 3.8 | 7 | 9.6 | 7.7 | 5.9 | 7.7 |
| Services | 8.3 | 7.7 | 9.8 | 9.4 | 8.4 | 8.1 | 7.4 |

***Source: Agriculture Statistics at a Glance***

The total geographical area, gross cropped area and the net sown area of the country is 328.7 million hectares, 198.4 million hectares and 140.1 million hectares respectively. Thus, the net sown are is only 43 percent of the total Geographical area (Land Use Statistics, 2014-15)

In 2016-17, country achieved a record production of food grains of 275.11 million tons and in 2017-18 the expected food grain production is 284 million tons. This is nearly 5.5 times jump from 51 million tons produced in 1951.The country estimates a targeted production of 300 million tons of food grain by 2025 to feed its population. This target seems to be achievable if we consider the average growth rate of production during last five years.

Though India has high level of production but it lags behind other countries in terms of yield. Comparison of crop yields with other countries reveals that though India leads in production of cereals and pulses but yields are very low. India ranks second only to China in the production of paddy in the world but its trails way behind China, Brazil and the Vietnam when yield are compared **(Figure 1.6)**. China, Brazil and Vietnam have yield of 6866, 5464 and 5574 kgs per hectare respectively compared to India's 3790 kgs. per hectare. India also ranks highest in pulse production but it ranks very low in terms of yield.

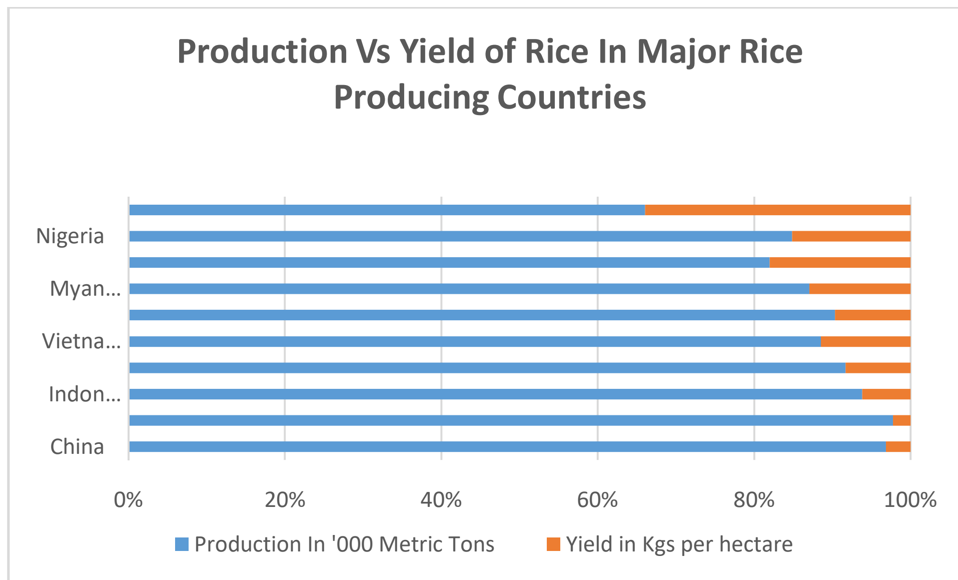


**Figure 1.6** Production Vs Yield of Rice in Major Rice Producing Countries | ***Sources:*** *Agricultural Statistics at a Glance 2018*

India follows China as the second largest producer of wheat but yield in India is only 3034 kgs. per hectare compared to China's 5396 kgs per hectare. France and Germany have yield of 5304 and 7641 kgs. per hectare respectively **(Figure 1.7)**

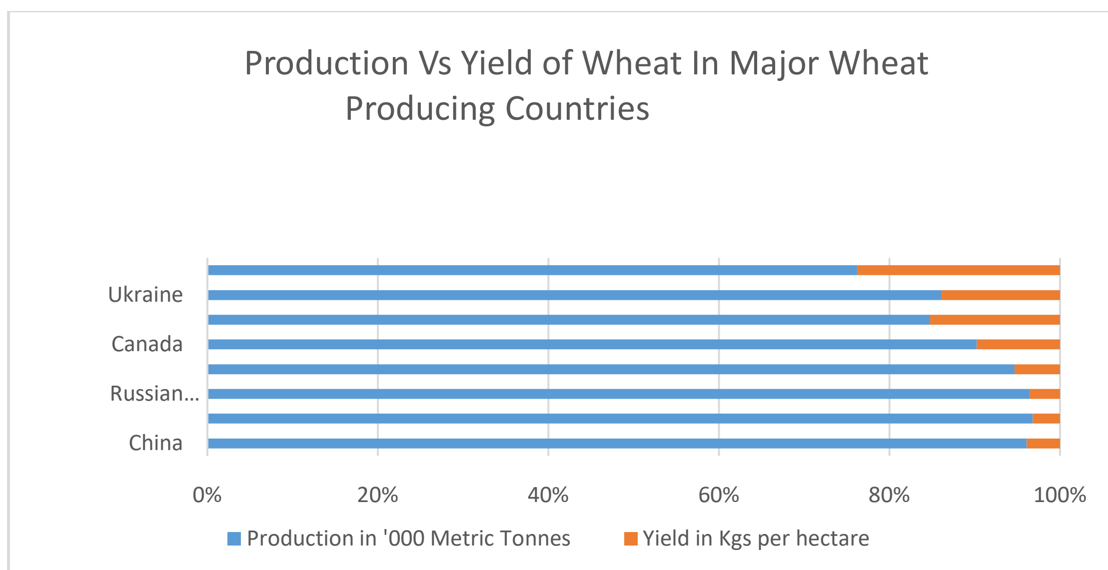


**Figure 1.7:** Production Vs Yield of Wheat in Major Wheat Producing Countries | ***Source:*** *Agricultural Statistics at a Glance 2018*

**Food Security**

Agriculture sector not only provides employment to rural masses but it also ensures national food security. The Food and Agricultural Organization (FAO) of the United Nations defines food security as a situation where all people have, at all times, physical and economic access to sufficient, safe and nutritious food that meets the dietary needs and food preferences for a healthy and active life.

As estimated in 2014, almost 15 percent of our population continues to be under-fed. In 2013, our country enacted the Food Security Act with the intention to ensure security to its people in terms of food and nutrition by providing sufficient quality food at economical prices. The act also envisages that specified group of people belonging to weaker sections of the society would be provided food

grains at subsidized price. It aims at providing subsidized food grain to nearly two third of the population. With increase in per capita income, the consumption pattern has shifted from cereal foods for nutrients to high protein foods specially pulses, egg, meat etc. One of the prime concerns of the Government is to enhance the intake of proteins.

**Fragmented Landholding**

The net cultivated area in the country is 140 million hectares. Over the years this land area has been fragmented into small pieces of land through division of assets among the family members. Another reason for fragmentation is the allocation of small holdings to tenant farmers by the large landholders.

In 1971 there were only 36 million marginal landholdings in India, which rose to 93 million in 2011and 99.8 million in 2016. Marginal land-holding are the ones whose area is less than one hectare. Sixty Seven percent of total landholdings are marginal in nature. The average land-holding size has reduced from 1.33 acre in 2000-01 to 1.15 acre in 2010-11 **(Figure 1.8).**

Farmers having marginal and small land holdings have to deal with various obstacles, like inability to mechanize and adopt best agricultural practices, achieve cost reduction through production on a large scale, capacity to bargain for remunerative prices etc.

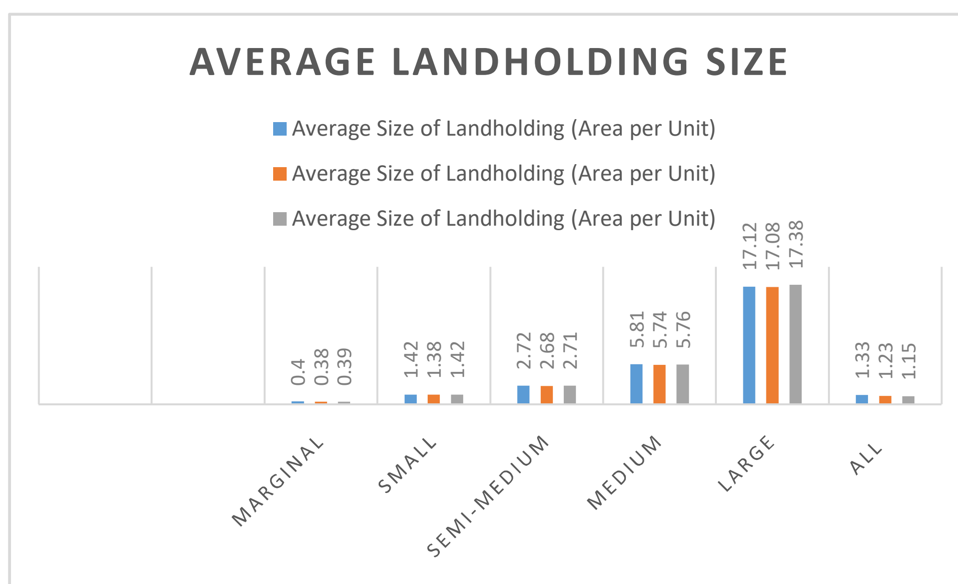


**Figure 1.8:** Land Distribution Pattern based on Size of the Land Holding | ***Sources:*** *Agriculture Statistics at a Glance, 2018*

**Tenant Farming**

Different states have different laws related to leasing of agricultural land. In most states leasing of agricultural land is prohibited; some states permit the buying of land by the tenant after a specified period of tenancy while others have passed law to prevent illegal eviction of tenants. A model land leasing law, which legalizes the leasing of land has been devised by Niti Aayog and circulated to the states for implementation. It is a win – win law for the landlord and tenants because the former would be assured of security of ownership and the latter would be assured of secured tenancy. The law aims to encourage the tenants towards long term investment in building agriculture assets which will increase productivity.

A formal Tenancy law would also pave way for the farmers to access loans from formal financial institutions, insurance coverage for crops, and various subsidies on inputs like fertilizers subsidy. It would provide security to the landlord that his land will not be usurped and the tenant would be assured that he would not be evicted from the land during the period of the lease. Madhya Pradesh is the only state which has enacted the Model land leasing law.

**Credit Issues**

Tenant farmers cannot approach banks and financial institutions for loan and insurance because they do not possess the title to the land. Most of these tenants are marginal farmers and they hold more than fifty percent of the agricultural landholding. They have access only to crop loan and none other. Research has pointed out that the marginal farmers have least access to institutional finance. They mostly meet their credit requirement from non-formal sources like moneylenders (41%). On the other hand, more than 50 percent of farmers with land holdings exceeding two hectares approach banks for credit. **(Table 1.9).** Other than the commercial banks, the other avenues for rural credit are the co-operative credit societies, traders and friends. The non-institutional lenders normally charge usurious rate of interest which the farmer finds difficult to repay and ends of losing his land which he had kept as collateral.

Credit can be classified in two parts- short term and long term. The tenor of Short-term credit is only one year. It is taken for crop production activities. Long term credit exceeds one year up to five years It is taken for purchasing assets like agriculture machinery, irrigation and other activities. Eighty six percent of farmers fall in marginal and small category and they mostly avail short term loan (crop loan) as compared to medium and large farmers. This implies that they do not invest in agricultural assets which are necessary to increase the future income. The share of long-term credit declined from 30.3 per cent 2008-09 to 22 per cent in 2012-13 mainly due to interest subvention on short term credit. However, from 2013-14 the share of long-term credit increased to 24.9 per cent and thereafter there has been continuous growth. In 2018-19 it reached the peak of 40.2 per cent, which is highest in a decade.

**Table 1.9** Distribution of sources of agricultural credit by land-holding size

| Distribution of sources of agricultural credit by land-holding size | | | | | | | |
|---|---|---|---|---|---|---|---|
| **Land Area (Hectares)** | **Type of Farmer** | **Co-op Society** | **Bank** | **Money Lender** | **Shopkeeper** | **Relatives/Friends** | **Others** |
| 0-1 | Marginal | 10% | 27% | 41% | 4% | 14% | 4% |
| 1-2 | Small | 15% | 48% | 23% | 2% | 8% | 6% |
| 2-4 | Semi Medium | 16% | 50% | 24% | 1% | 6% | 4% |
| 4-10 | Medium | 18% | 50% | 19% | 1% | 7% | 6% |
| 10+ | Large | 14% | 64% | 16% | 1% | 4% | 2% |

**Source:** Agriculture Census, 2011

**Access to Insurance**

Agriculture in India is dependent on rainfall. In case of deficit of rainfall there is drought and in case of excess rainfall there is flood and in both these situations the farmer faces crop loss and a bleak future. The Pradhan Mantri Fasal Bima Yojana was started in 2016 along with the Restructured Weather Based Crop Insurance Scheme (RWBCIS). Under the scheme insurance coverage was

compulsory for farmers who had taken crop loans and voluntary for non-loanee farmers. The premium applicable to the farmers was only 2% of the sum insured for kharif crops and 1.5% for all Rabi crops. The maximum premium was fixed at 5 percent of the sum assured for commercial and horticultural crops. The focus of the scheme is to support the farmers in case of crop failure by covering the risk through insurance scheme, thus stabilising the farmers' income, the farmers have to pay a very low premium and remaining would be shared equally by Central and State Government, so that the farmer receives the full insured amount in case of crop failure due to natural calamities. The scheme embraces all categories of farmers, including tenant farmers and sharecroppers, who grow notified crops in notified areas. It encompasses all types of crops e.g., cereals, pulses, oilseeds, vegetables, and spices.

**Some long outstanding problems associated with the crop insurance system include:**

- **i.** Lack of awareness about insurance,
- **ii.** insufficient coverage of existing insurance schemes,
- **iii.** delay in evaluation of magnitude of loss in case of crop losses,
- **iv.** delay in settlement of claims.

The tenant farmers and share croppers are not eligible for agricultural insurance since they do not have title to the land. There is recommendation by the Standing Committee on Finance that evaluation of damages to crops should be concluded and compensation for damages should be reimbursed directly into farmers' accounts in a timely manner.

**Irrigation**

Currently about 53 percent of area under food-grain cultivation is irrigated. The rest area is rain fed. The sources of irrigation in the country can be classified in two parts: i) ground water sources e.g., wells, tube-wells and ii) surface water sources e.g., canals, tanks etc. Ground water sources are mainly exploited for irrigation. Ground water sources are used for irrigation by almost 65% of the irrigated land holdings. **(Table 1.10).**

**Table 1.10:** Sources of irrigation (as of 2010-11)

| Sources of irrigation (as of 2010-11) | | |
|---|---|---|
| **Source of Irrigation** | **Percentage Share of Holdings** | **No. of Holdings** |
| Bore Well | 44.20% | 31,722 |
| Canals | 25.70% | 18,414 |
| Wells | 19.70% | 14,101 |
| Other Sources | 8.40% | 6,046 |
| Tanks | 5.80% | 4,180 |

***Source:*** *Agriculture Census 2011*

Excessive overuse of ground water has happened in most states specially those which cultivate high water consuming crops. In Punjab, nearly 75-90 percent of ground water is over exploited leading to depletion in ground water level. A model bill to regulate the use of Ground Water was formulated by The Ministry of Water Resources for enactment by the states. It was called the Model Bill for Groundwater, 2016. The Bill draws institutional guideline for the governance, usage and conservation of groundwater resources. It designates groundwater as a common resource of all

persons with collective ownership. This means that the ground-water resource below a piece of private land does not become the property of the landowner. The owner cannot dissuade others from using it. It also provides for water charges for bulk /commercial use of water.

A paradigm shift from flood irrigation to micro-irrigation has been advised. It consists of drip irrigation and sprinkler irrigation. Micro Irrigation reduces the consumption of water and also the cost of irrigation. Focusing on increasing water use efficiency will enable the country to bring more cultivable land under irrigation network.

### 1.5 Challenges to Indian Agriculture

As described previously in this chapter, the problems related to Indian agriculture are multi-fold. Some of these issues like low yield, fragmented landholding, tenant farming, and lack of mechanization are more techno- legal in nature and Government is attempting to solve them through technical and legal changes. Agriculture research is working towards increasing the crop yield per acre by developing new high yield varieties of seed. Similarly, Niti Aayog has devised a model law to give legal sanction to land leasing and it has advised the states to implement it. Many states like Punjab and Haryana have passed the legislation for consolidation of agriculture holdings which gives power to the Government to consolidate the holdings and prevent fragmentation of holdings. A model bill to regulate the use of Ground Water was formulated by The Ministry of Water Resources for enactment by the states. It was called the Model Bill for Groundwater, 2016.

However, those problems which have a direct bearing on agriculture income and farm poverty are: 1) Lack of Employment Opportunities & Hidden Un-Employment 2) Lack of market infrastructure and remunerative prices 3) Lack of Institutional Credit for small and marginal farmers. These are described in details hereafter.

#### Lack of Employment Opportunities and Hidden Employment

Based on the decadal population census it is evident that the contribution of agriculture in total GDP has seen a sharp reduction (Figure 1.9). It is also evident that the proportion of rural workers in the total workforce has also declined. (Figure 1.10)

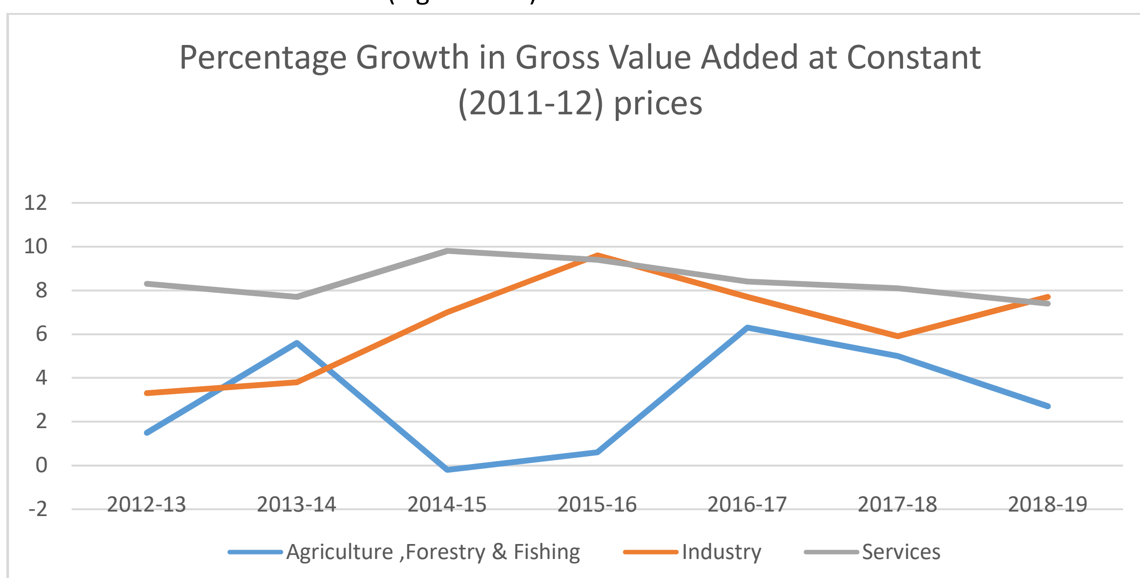


**Figure 1.9** Percentage Growth in Gross Value Added at Constant (2011-12) prices | ***Sources**: Agricultural Statistics at a Glance 2018*

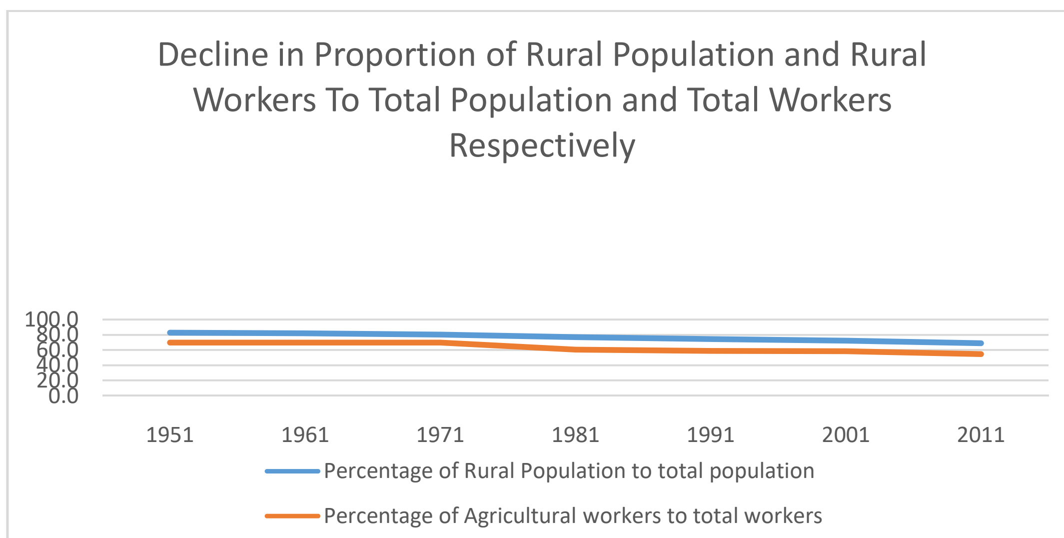


**Figure 1.10:** Proportion of Rural Population and Rural Workers to Total Population and Total Workers Respectively | ***Sources:*** Agricultural Statistics at a Glance 2018

However, when we compare the fall in GDP share and the decline in share of rural workforce with other countries, we find that they are not commensurate. One reason for this is that there is very little scope for Non -Farm Jobs to absorb the surplus workforce resulting from declining in the share of GDP. Secondly, the skill set of the agrarian workforce is very limited making them unsuitable for shifting to other sectors.

Such high dependence of majority of the rural population on agriculture makes them unsafe in case of fluctuation in agriculture production since it effects the earnings of majority population. Any disruption in the agricultural production has a compounding effect on rural income and poverty.

It is necessary to broaden the skill set of the agriculture workers so that they can shift to non- farm and near farm employment. Near farm employment refers to activities which follow crop harvesting like storage, transport, marketing, food-processing etc. which provides employment and also helps the farmer to get better price for their produce. Near Farm Employment will also benefit the Consumers by providing them high quality products at lower prices.

Development of Secondary and Tertiary sector is a necessary step to reduce the employment pressure on agriculture.

**Steps taken by Government to address the issue of Rural Unemployment**

Various steps have been taken by Government to develop the secondary and tertiary sectors so that the workforce gets diversified. They include:

1. Start-Up India initiative to build up enterprises through innovative ideas- Start-up India initiative was launched by the Government of India on 16th January 2016. There are three aspects on which this initiative focusses on:
    i. Simplification and Handholding-This includes easier compliance, easier exit for failed start-up projects, legal support, fast tracking of patent application and a portal to disseminate information

ii. Funding Support and Incentives. -These measures include exemption on income tax and capital gains tax for eligible start up, setting up of a fund to infuse more capital into the start-up ecosystem and credit guarantee scheme.
iii. Industry-Academia Partnership and Incubation-This involves creation of incubators and innovation labs in academic institutes and organising events and competition to generate ideas.

A start-up unit has been defined by the following parameters:

i. It should have its head-office in India
ii. It should have started in less than 10 years,
iii. It should have less than Rs 100 crore annual turnover
iv. Its legal structure should be either a Private Limited Company under the Companies Act, 2013 or Partnership Firm under Partnership Act, 1932 or a Limited Liability Partnership Firm under the Limited Liability Partnership Act, 2008.

In the rural segment the Department of Animal Husbandry is implementing the dairy entrepreneurship development scheme for generating self- employment opportunities in the dairy sector. NABARD provides backend subsidy for dairy projects which are considered suitable for banking. Scheme for Regeneration of Traditional Industries (SFURTI) is another project for rejuvenation of traditional industries. It will provide sustained employment for traditional industry artisans and rural entrepreneurs. Khadi & Village Industries commission is the nodal agency implementing the scheme.

2. Deen Dayal Grameen Kaushal Vikas Yojana - This initiative is meant to help the rural youths from poor families to develop skills and productive capacity which makes them more efficient and boosts their demand in the job market. The training emphasizes on applied knowledge of the job so that the youth is ready for employment immediately after completion of the course and the employer need not invest in training. The programme is managed by the Ministry of Rural Development and implemented through Project Implementing Agencies which are organizations registered under trust act or state societies act or state co-operative society act or limited liability partnership act or as a Government or Semi Government organization providing training and placement.
3. Pradhan Mantri Mudra Yojana – This scheme provides loan upto Rs 10 lakhs to non-corporate, non-farm small and micro-enterprises. The loan is given through banks, RRBs, Small Finance Banks, MFIs and NBFC. There are three categories of loan: Shishu (maximum loan Rs 50000), Kishore-maximum loan above Rs 50000 to Rs 500000 and Tarun- maximum loan above Rs 500000 to Rs 1000000. The loans are meant to promote entrepreneurship among the aspiring youth and for generating income and employment. The Rural Non-Farm Industries which are normally very small and hence fall under the micro and small industry segment are eligible for Mudra loan. The loans are extended for:
    i. Loan to Vendors, Traders, Shopkeepers and other Service Sector for business
    ii. Working capital loan through MUDRA Cards
    iii. Equipment Finance for Micro Units
    iv. Transport Vehicle loans – for commercial use only

v. Loans for Agri-allied non-farm income generating activities, e.g., pisciculture. Bee-keeping, poultry farming, etc.
vi. Tractors, tillers as well as two wheelers used for commercial purposes only.

**Issues Related to Marketing Infrastructure**

Indian Farmers do not get remunerative price for their produce due to lack of markets near the farm gate and hence they are unable to get the remunerative price for their produce. Hence Government has always taken steps to augment the marketability of agriculture produce.

Agricultural markets in the country have been set up and controlled by rules stated in Agricultural Produce Marketing Committee (APMC) act. This act authorizes the state Government to demarcate certain areas as notified market headed by a market committee. Farmers have to sell their produce at these state-notified markets. However, over the years the market committees have become monopolistic bodies not devoted to the cause of farmer's welfare. APMC markets charge market fee from farmers willing to sell their goods in the mandis. This adds to the cost of the farmer and reduces his profit. APMC act prohibits farmers from selling produce outside the market yard so farmers have to incur cost of logistics to bring the produce to the market. Farmers have to pay commission to various intermediaries while bringing the produce from the farm to the storage facility which adds to his cost. The price at which the farmer sells his produce in the market is much less compared to the price at which the produce is finally sold to retailer.

Thus, one prominent reason is the lack of adequate number of markets where the farmer can sell the produce. Network of regulated market across the country needs to be scale up and alternative vehicles for marketing (like direct marketing to prospective buyers, contract farming etc.) have to be provided where the farmer can discover the right price of the produce. Development of regulated market with modern infrastructure and private sector participation may be a step in right direction.

The Government has framed the Model APMC act, 2017 which attempts to mitigate the drawbacks of existing law. Its key highlights are:

a. Farmer can sell the produce directly to buyer of his choice e.g., contract farming,
b. Private investors and businessmen, farmers and consumers can invest in developing market infrastructure
c. There is only one-time market fee which entitles the farmer to sell in any APMC market.
d. Market agencies can operate in more than one market through a single registration. Separate licenses are not required to operate in different market.
e. removes provision of essentiality of shop in market premises
f. farmers can sell their produce directly to consumers;
g. promotes online trading

Implementation of National Agricultural market Scheme, as recommended in Economic Survey 2014-15, to provide Online trading portal to farmers for transparent transaction and price discovery is a top priority. The agricultural markets will be linked to the portal. Due to broad based market access farmers would be able to sell the produce anywhere within the country where they get best price offer. Development of storage and preservation infrastructure facilities like warehouses, cold store chains under RIDF/WIF are also envisaged

The production, supply and distribution of some of the agricultural commodities fall under the ambit of the Essential Commodities Act, 1955. The list of Agri-commodities encompasses -food grains, oilseeds, cotton and woollen textiles, jute etc. The act empowers, the central government to decide on the stock limit of agriculture commodities held by traders and thus control the price. The act also empowers the Central Government to control the licenses for storage, transport, distribution, disposal or consumption of essential commodities.

**Farmer's Indebtedness**

Profitability of farming operations depends much on timely availability of bank credit at reasonable price. Profits make farming sustainable and farm investment rises. Farm Investment is necessary for increasing farm productivity and generates long term profit. Difficulties encountered by small and marginal farmers in availing institutional credit at optimal price, restricts their ability to adopt mechanized farming and latest agricultural tools and techniques necessary for enhancing agricultural productivity.

Records show that Marginal and Small farmers have less access to institutional credit compared to Medium and Large farmers. Only 29 percent of marginal farmers have taken loan from formal financial sector compared to 52 percent of large farmers (Table 1.11). This proves that the institutional credit does not reach the poorest class who need it the most.

**Table 1.11:** Distribution of Institutional Credit to different categories of farmers

| Distribution of Institutional Credit to different categories of farmers | | | |
|---|---|---|---|
| **Size Group (hectare)** | **Total no. of operational holdings** | **Estimated number of operational holding that took institutional loan** | **Percent of operational holding that took institutional loan** |
| Marginal | | | |
| (Below 1) | 92688 | 26508 | 28.60 |
| Small | | | |
| (1.0-1.99) | 24746 | 11021 | 44.54 |
| Semi-Medium | | | |
| (2.0-3.99) | 13869 | 6583 | 47.47 |
| Medium | | | |
| (4.0-9.99) | 5854 | 3011 | 51.43 |
| Large | | | |
| (10 and above) | 953 | 500 | 52.47 |

***Source:*** *NABARD*

**Summary**

1. The rural economy is identified by two important aspects: 1) Agriculture which is the primary occupation and 2) Poverty which is omnipresent
2. The contribution of agriculture in the rural economy has been declining over the years.

3. Decline in share of agriculture in the national income does not reduce its importance because it provides food security to 130 crores population and employs more than 50 percent of the population.
4. As value addition by agriculture to the national income declines it becomes imperative to develop the Rural Non- Farm Sector so that employment can shift from farm sector to the non-farm sector.
5. Development of Non- Farm sector will also mitigate the problem of migration from rural to urban areas causing increasing pressure on urban infrastructure.
6. Low income and inadequate savings leaves very little scope for poor people for capital formation and investment required to break the vicious cycle of poverty.
7. Access to affordable source of finance when required enables the poor to get the much needed capital for investment and income generation.
8. When finance becomes available, industrial development is initiated and new investment opportunities arise
9. Finance can be classified into different categories based on: 1) Source Generation 2) Tenor 3) Ownership
10. Rural Economy needs finance for various reasons like- household consumption, purchase of inputs (working capital), cope up with crop failures, purchase assets or to fulfill social obligations.
11. Rural households have various option to meet the financial requirement like Savings Up , Savings Down(Credit borrowings) , Savings through , Remittances, Social Network , sale of assets ,social entitlements, job diversification
12. They can take finance either from institutional or non-institutional sources.
13. Government has always attempted to bring the rural masses under the purview of institutional sources of finance so that they get adequate credit at affordable rates and do not fall into the clutches of moneylenders.
14. Social Banking Policy increased the number of Branches in rural areas and credit flow also increased. However, the small and marginal farmers are still dependent on the non-institutional sources to meet their financial needs.
15. Indian Agriculture is characterized by the following features:
    a. India's food-grain production has grown over the years but the yield is less compared to other countries.
    b. Despite high levels of production in the country and having a Food Security Act, 15% of the population continues to be under-nourished, as per 2014 estimates.
    c. Nearly 86 percent of total number of landholdings in the country is less than two hectares.
    d. Farmers having marginal and small land holdings face a number of problems, such as mechanization and adopting best agricultural practices, achieving economy of scale for cost reduction, getting remunerative prices etc.
    e. Tenant farming and sharecropping are most common in rural areas. Such farming does not have legal sanctions in most states.
    f. Subsidized Crop Insurance Scheme for farmers suffers from many weaknesses like Lack of awareness about insurance schemes, inadequate coverage, delay in

assessment of the extent of damages in case of crop losses and Timely settlement of claims.

g. Currently about 53 percent of area under food-grain cultivation is irrigated. The rest area is rain fed.
h. There has been an overuse of ground water sources in states, especially those growing water intensive crops.

16. There are three main challenges to Indian Agriculture:
17. Excessive dependence for employment
18. Developing Market Infrastructure
19. Farmer's Indebtedness
20. Share of GVA of agriculture and allied industries in national income has declined but there has not been a proportionate decrease in employment.
21. Secondary and tertiary sector in rural areas have to be developed to diversify the employment by increasing the number of employers.
22. Government has started the Skill India, Make In India and Start Up India programs with the intention to solve the problem of unemployment.
23. Indian Farmers do not get remunerative price for their produce due to lack of markets near the farm gate.
24. Network of regulated market across the country needs to be scale up and alternative marketing channels (like direct marketing, contract farming) have to be provided where the farmer can discover the right price of the produce.
25. Government has enacted the Model APMC Act, 2017 for development of regulated market with modern infrastructure and private sector participation.
26. Government is also in the process of linking the various Agricultural Markets through ENAM web portal to promote transparent transactions and better price discovery.
27. Access to institutional loans are so skewed against the farmers with small land holdings that the lowest size of land holdings (less than 1 hectare) were estimated to have only 29 percent of loans from institutional source vis-a'-vis about 52 percent in case of highest size of land holding (more than 10 hectare)

**Model Questions**

1. What are the reasons for poverty in rural areas?
2. Why is it important to focus on the growth of the Rural Non-Farm Sector?
3. Why is it important to develop the rural economy?
4. Why is finance so important for: 1-Individual and 2- businesses?
5. What are the parameters which businesses evaluate for choice of finance?
6. What are the various classification of finance?
7. What are the ways of raising finance from the International Market?
8. Why is there a need for finance in the rural economy?
9. What are the various options available to rural households to meet the financial needs?
10. Explain the directed lending multi agency approach for credit delivery?
11. What are the problems faced due to a) Fragmented Land-holding b) Tenant Farming?
12. What steps has the Government taken to increase the water use efficiency?
13. What are the drawbacks in the crop insurance scheme being promoted by the Government?

14. Why is there a concern for employment in the agricultural sector and what are the remedies to diversify the employment?
15. What steps has the Government taken to provide markets to the farmers?
16. What are the salient features of the Model APMC act, 2017

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# Chapter 2 Structure of Rural Finance

## Introduction

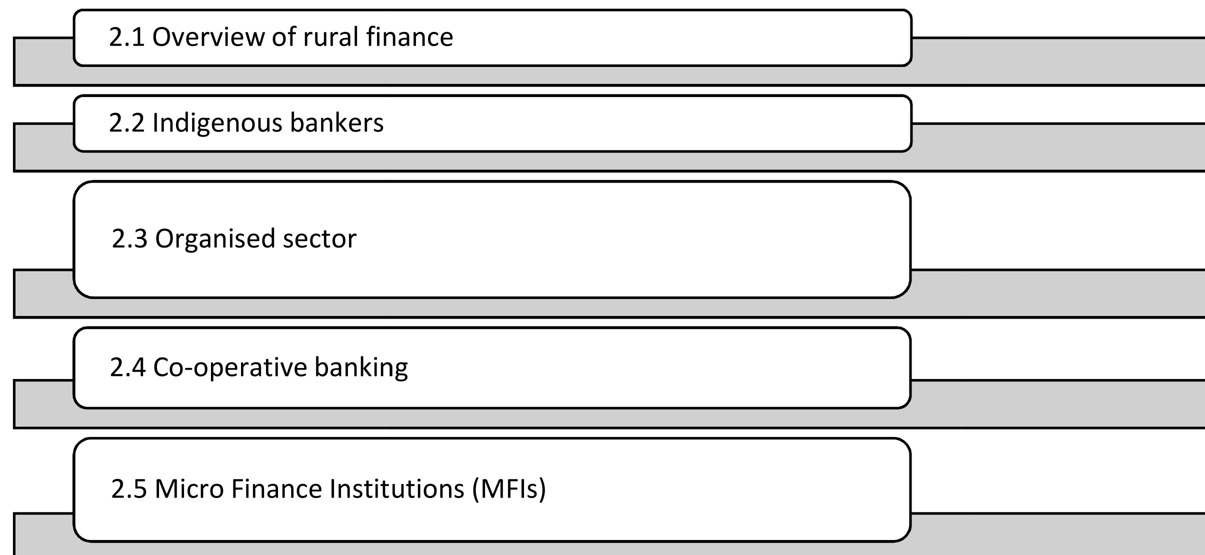
This chapter covers the structure of Indian rural financial landscape. The discussions about formal as well as informal organizations have been done. The existence of commercial banks, cooperative banks, Microfinance institutions and development financial institutions in our country has contributed towards the creation of rural financial system of the country.

## Objectives

The objective of the chapter is to familiarize the students about the structure of rural financial system. The students should be in a position to visualize, the different ways through which a person living in rural part of our country can avail the financial services.

1. To familiarize the students about rural financial structure in India
2. To appreciate the informal financial system
3. To understand the broad functioning of Regulators and supervisors of Indian banking system
4. To comprehend the functioning of commercial banks
5. To gain knowledge of three tier structure of cooperative banking system
6. To understand the functioning of Microfinance Institutions

## Chapter Structure




## 2.1 Overview of rural finance

Rural people are getting finance from informal as well as formal sources. Informal sources would include relatives, moneylenders, retailers, etc., whereas formal sources would include banks, MFIs etc. it is found that a good share of rural finance is still in the hand of informal players. The figure 2.1 gives a broad view about the players involved in the rural finance.

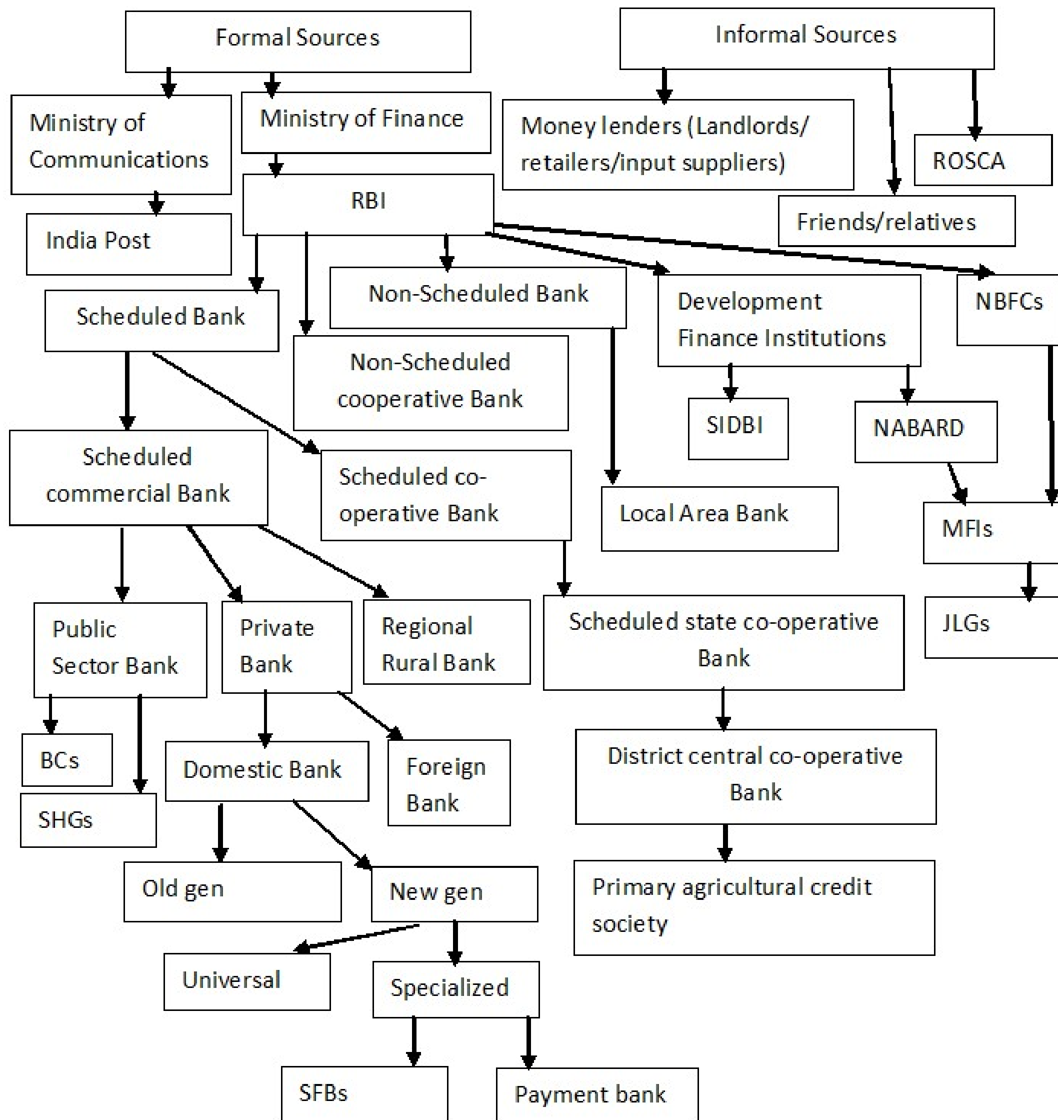



**Figure 2.1:** Structure of Rural Finance **|** **Source:** constructed by Authors

Institutional players include commercial banks, cooperative banks, small finance banks, payment banks and development financial institutions. Non-institutional players comprise the presence of moneylenders, landlords, retailers/input suppliers and friends/relatives. Each of these players is relevant and is providing access to financial services based on the needs of rural consumers.

In rural India, first preference for getting credit goes to informal sources. People first approach their friends and relatives, and in most of the cases it will not involve any interest. The next source would be institutional players because of less interest rate being charged by them. But, in many cases rural people do not get access to credit by institutional players, because of lack of proper document, higher transaction cost, high risk, improper product etc, that is where moneylenders come into the picture. The moneylenders are also of different types based on time devoted by them on this profession: full-time and part-time. In any case, they would be from the same place and would have in-depth knowledge of the people in the search of credit facility. This information helps

moneylenders in deciding about the interest rate: in the case of emergency, they usually charge more as they are aware about the sources of credit available to these people. Higher the number of alternative sources less would be the interest rate charged. Part-time moneylenders would be usually landlord, retailers operating in the same area and suppliers of input materials for agriculture purposes. These part-time moneylenders usually take less interest rate, but compensate it forcing to do some other remunerative activities for them. For example, retailers would force farmers to sell the agriculture produce to them at lower price or Agri-input suppliers charging more prices to the products selling the farmers.

Under institutional players, we have regulatory and supervisory bodies like Reserve Bank of India (RBI) and Development Financial Institutions (DFIs) working under Ministry of Finance. In addition, we also have India Post working under Ministry of Communications and providing some of the banking services. Now, India post has also got the license for bank, and working as payment bank. The presence of India Post is going to help them in reaching the farthest area of the country. Under RBI, which is the central bank for the government and regulates all the banking activities of the country, we have DFIs, scheduled banks, non-scheduled banks, and Non-Banking Financial Institutions (NBFCs). In DFIs relevant to rural area, we have National Bank for Agriculture and Rural Development (NABARD) looking after the policy related issues of agriculture and allied activities, and small Industries Development Bank of India (SIDBI) fulfilling the needs of Micro, Small and Medium Industries in rural area.

The difference between scheduled and non-scheduled banks is in the inclusion in the Second Schedule of the RBI act, 1934; those who are included are called scheduled banks. The Indian banking system is dominated by scheduled banks; while in non-scheduled banks we have presence of three banks only with minimal market share in the banking industry. Under scheduled banks, India has scheduled commercial banks and scheduled cooperative banks. Under scheduled cooperative banks, banks are divided based on long-term and short-term lending and work under either three-tier or two-tier system.

Scheduled commercial banks comprise public sector banks (PSBs), private sector banks and regional rural banks. The regional rural banks are the sponsored banks of the PSBs. In the private banks, we have the presence of domestic as well as foreign banks serving the needs of financial sector. But, for the rural financial landscape, foreign banks are not so relevant. The major share would be taken by PSBs, when it comes to rural financial system. They have increased their penetration through a very successful program called Self-help group-bank linkage program, in addition to their presence in the rural area through branches. The RBI has also initiated Business Correspondent Model, to reduce the gap between banks and rural people, wherein individuals/organizations were allowed to provide the banking service on behalf of banks. Here, technology was helping the business correspondents to reach the unbanked population. The government has tried increasing the role of private banks by offering new licenses to niches banks i.e., Small Finance Banks (SFBs) and Payment Banks to serve the needs of rural people especially the poor with the mandate of financial inclusion. These SFBs have the experience of serving the rural people and are expected to continue to do the same with increased scale. Payment banks with certain restriction like Rs. 1 lakh deposit per customer are mainly there to facilitate the financial inclusion by using technology. These payment banks can apply for the license of Small Finance Bank after operating for five years.

In addition, Non-Banking Financial Companies also have very good presence in the rural area. They are trying to fill the gaps of rural credit by having less documentation, providing desired products etc. the noteworthy among them would be Micro-finance institutions. These MFIs are mostly operating through joint liability groups. In addition, these NBFCs have also attempted to fill the credit gap for rural industries very well. The importance of the small industries in rural economy is well known, and they also face credit crunch. These NBFCs with their flexible approach have reduced the credit gap. Here, we need to be aware that not all NBFCs are regulated and supervised by RBI. Certain institutions like cooperatives face multiple regulatory bodies. NBFCs also have presence of housing companies, chit funds, insurance companies etc. and they also operate in the rural area, but come under different regulatory bodies. For example, Insurance Regulatory Development Authority regulates insurance companies and these companies are very relevant for the rural areas in terms of providing services like crop insurance, life insurance, micro-insurance etc. Given their low level of penetration, they have to make strategy to increase their penetration in the rural area.

### 2.2 Indigenous Bankers – Money Lenders

India has traditional banking system in place where communities like "Chettiar" "Rastogi" "Shikarpuris", "Gujarati shroffs" having their own network and providing banking services to the population. These indigenous bankers were unregulated and worked mainly on trust. They provided loan facility as well as deposit services to the people. The "Hundi" system, which was like a promissory note issued by the bank, was instrumental in running the business in old days. They also spread across the country based on the demand of the customers they were dealing with. They used to operate in similar fashion, their segment was different e.g., Chettiars were serving to all segments in south India, whereas Rastogis served mainly to traders and craftsmen. Their association with customers was informal in nature, and in addition to banking services they will also perform some informal works like providing accommodation, opening the office as and when customers required. Their presence was very crucial even during Mughal period, as they used to provide banking service and provide fund to all strata of the society starting from poor to kings. Even during British periods, they were very strong in the society, and recognizing it British government recommended strengthening the formal banking system rather than remaining dependent on these indigenous bankers. Initially Indigenous bankers like Chettiars were in good terms with British government and spread their businesses even in the neighboring countries like Burma.

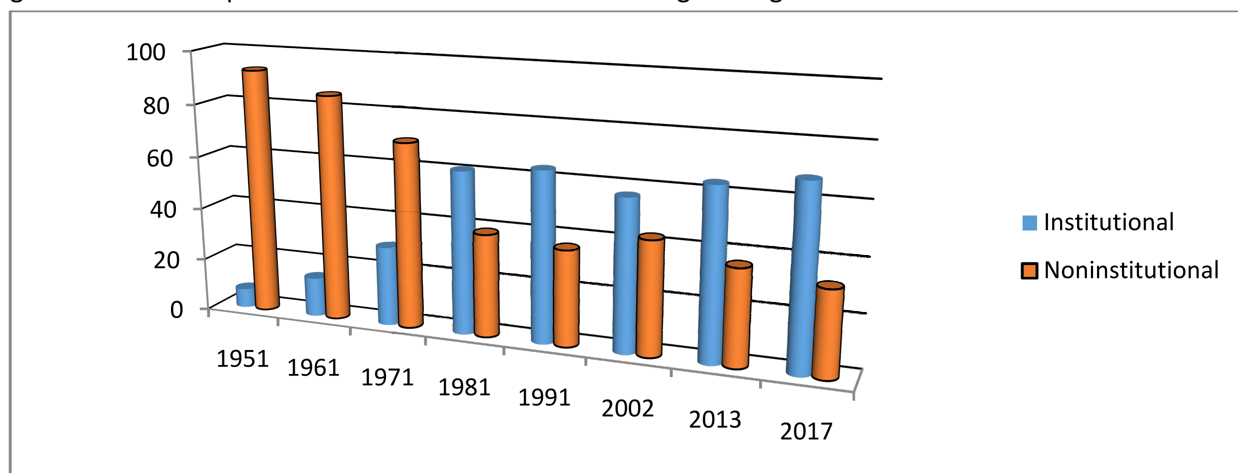



**Figure 2.2** Institutional and Non-Institutional Rural Credit over the years (in percentage) | **Source:** Pradhan (2013), NAFIS 2017

Even at present, with the existence of so many organized players in the financial sector, a large number of people are availing the banking services from non-institutional or informal sources. Although, share of institutional players has increased over the years, we need to be vigilant in seeing the data, as many consumers are using services from both institutional as well as non-institutional players. Figure-2.3 illustrates the overlap of percentage of consumers taking loan from both types of players.

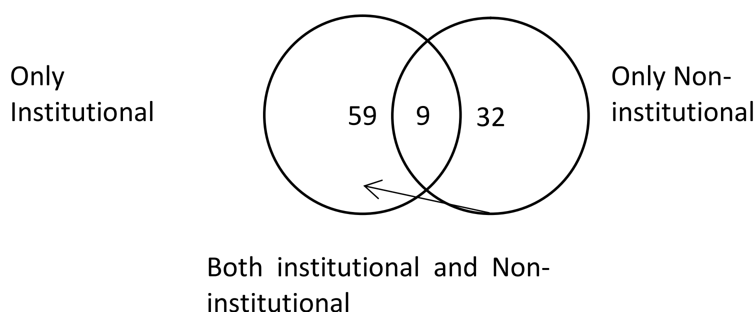



**Figure 2.3:** Sources of loan (in percentage) **| Source:** NAFIS, 2017

Amount of loan taken during one year from non-institutional sources is more than double than the amount taken from institutional sources. It shows the dominance of these players in the rural area.

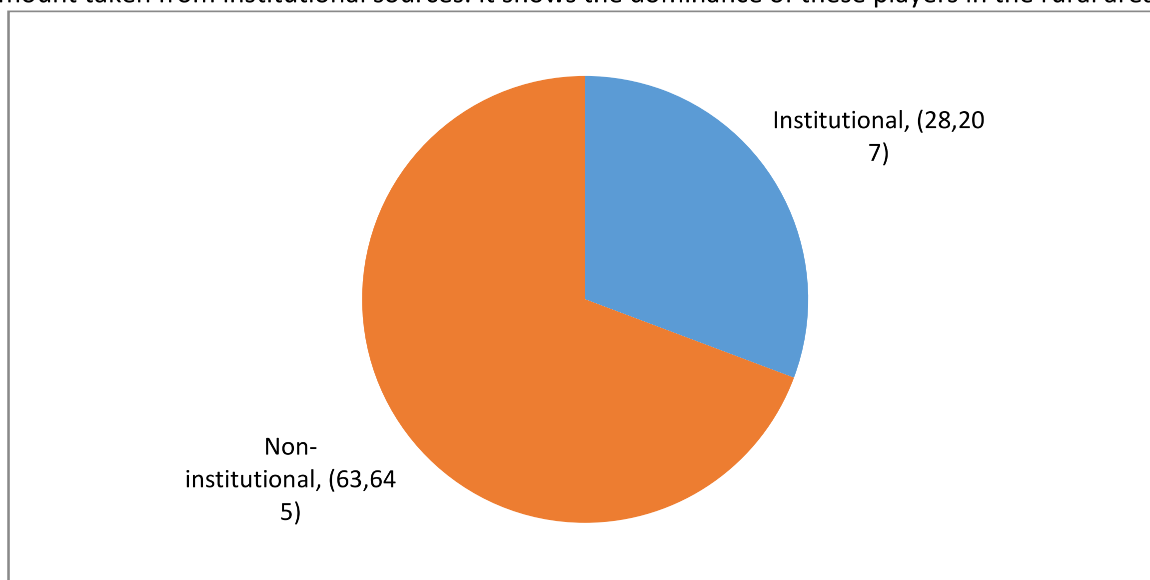



**Figure 2.4:** Average Amount of loan per household taken in last one year (in Rs.) | **Source:** NAFIS, 2017

Existence of informal finance can be attributed to 1) the inadequate supply of formal credit, 2) implementation issues related to policies, 3) the consumer related issues, 4) the institutional weaknesses of financial players, and 5) little or no documentation. Even after so many years of concerted efforts, we have not reached to everybody; there is supply-side constraints affecting the ability of formal institutions to cater the needs of rural people. The government has made many policies increase the penetration of institutional players, but implantation of it has not given the desired. The consumer related issue i.e. demand side issues like lack of awareness; financial

capability etc. also has also promoted the survival of informal finance. In addition, each of the formal organizations has their own limitations inhibiting them in reaching to the rural poor. They need documentation, and many times rural people do not documents readily available with them.

Moneylenders are a heterogeneous category; comprising a range of people/institutions like friends, relatives, landlords, retailers, input suppliers. These informal credit suppliers usually provide small-scale credit, to unbanked people. The moneylenders are known as "*mahajans" "Sheth" etc.* in rural vocabulary. They are from the same place, so they have all the information about the customers being served by them. Traditionally, rural India has used the services of moneylenders to meet its financial needs. It provided easy access to finance, but at very high interest rate leading to debt trap for the poor. Moneylenders mainly cater to the needs of people who remain un-served by the institutional players because of lack of paper, high transaction cost, high risk, inappropriate product etc.

So, riskier customers are being dealt by these players. How, moneylenders are able to deal with it? Answer to this, would be on the social relationship of these players with the customers. There is no information asymmetry between these two players, supplier of money is very well aware about the capability of borrower and the purpose of borrowing and has the ability to intervene at any point of time using his/her social power. Usually these moneylenders are from dominant position in the society. Many a times the relation between lender and borrower is exploitative because the lender controls other markets on which the borrower also depends.

Most of the studies try to brand moneylenders as villain in the society exploiting the rural poor, but we need to be aware about their contribution in providing timely financial services to unbanked population. We cannot dent the contribution of moneylenders in keeping petty production in rural area alive where institutional finance would never reach. If we break down the components of interest rates, including the higher risk component, then there is little evidence of monopolistic or exploitative profits being made by moneylenders. In addition, unlike institutional players where rural poor have no bargaining power, in the case of moneylenders, because of social proximity both lender and the borrower know each other very well and they usually bargain for the interest rate.

Another indigenous system of availing the financial service is Rotating Savings and Credit Associations (ROSCAs), which is called by different names such as "Bishi", "chit", "cooperative", "committee" etc. in different parts of the country. In a ROSCA, a group of people deposit equal amount of money on a regular basis, which gets allocated partly or fully to participants in rotation. For example, eight men/women meet every month and contribute Rs. 100 each to a fund, which in turn is handed over to one of them. Next month again, everybody contributes and another person gets the fund, this continues till everybody has received the money. So, by the end of eight months, each one of them would have received Rs. 800.

Group-based microcredit system is the most commonly used credit system by MFIs; it has become a globally adopted anti-poverty intervention and a tool for financial inclusion. In fact, group-based microcredit models have been largely influenced by the indigenous system of rotating savings and credit associations (ROSCAs).

## 2.3 Organised Sector –Banks –Structure of Indian Banking System- Public Sector Banks-RRBs- Private Sector Banks- NBFCs

Organized players in India mainly comprise banks, which is regulated by Reserve Bank of India (RBI). In addition, India post also has very good penetration in rural India with more than 1 lakh braches across the country. The government has always tried to serve the financial need to rural people and in this direction nationalization of scheduled commercial banks was done in 1969 and 1980. In addition, other policy initiatives like the implementation of social banking policy, branch licensing policy, providing credit to the priority sectors and establishment of regional rural banks were also taken before 1990s. After liberalization, India witnessed entry of many foreign banks but their contribution in rural fiancé is minimal.

**Regulators/Supervisors/Development Financial Institutions**

**a. Reserve bank of India**

The Reserve Bank of India (RBI)is the central bank for the government and was established in 1935, with the Reserve Bank of India Act, 1934, and latter got nationalized in 1949 through the Reserve Bank (Transfer of Public Ownership) Act, 1948.The RBI has 29 departments focusing on different policy issues. It has offices at 31 locations across the country.

The functioning of the banks can be summarized in the preamble of the central bank:
"to regulate the issue of Bank notes and keeping of reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage; to have a modern monetary policy framework to meet the challenge of an increasingly complex economy, to maintain price stability while keeping in mind the objective of growth."
The RBI is involved in framing monetary policy, issuing currency, regulating and supervising banks, managing public debt, managing foreign exchange, supervising payment and settlements, and providing finance to sector of national importance. It acts as bankers' bank by being a source of reserves to the banking system as well as the lender of last resort. In addition, RBI is actively involved in Consumer Education and Protection. It also conducts research and disseminates data related to financial institutions.

**b. National Bank for Agriculture and Rural Development (NABARD)**

NABARD is an apex DFI for rural India, which came into existence in 1982. The Vision of the bank is "Development Bank of the Nation for Fostering Rural Prosperity". The bank is instrumental in making policies related to agriculture and rural finance. The work involves financial, developmental and supervisory role for the institutions involved in rural financing. In addition, NABARD also has sponsored schemes related to farm as well as non-farm sector. Under finance related work, bank is involved in direct finance and refinancing. The bank is involved in institutional building activities and conducts research under its developmental work. It also supervises the Regional Rural Banks (RRBs), State Co-operative Banks (StCBs) and District Central Co-operative Banks (DCCBs).

**c. Small industrial Development Bank of India (SIDBI)**

SIDBI is a DFI, which Came into existence in 1990, and is meant for promoting the small-scale industries of India. A large number of small-scale industries are in rural area, so its role for

the upliftment of rural people becomes very pertinent. It acts as a single window for fulfilling the financial as well developmental needs of Micro, Small and Medium Enterprises.

**Table 2.1:** Development over the years at SIDBI

| Year | Development |
|---|---|
| 1990 | Formation of SIDBI |
| 1994 | Establishment of Microfinance Laid |
| 1995 | Technology Bureau for Small enterprise (TBSE) was setup which got converted into India SME Technology Services |
| 1999 | Founded SIDBI Venture Capital Limited |
| 2000 | Formation of Credit Guarantee Fund Trust for Micro & Small enterprise(CGTMSE) |
| 2005 | Establishment of SMERA Ratings Ltd. |
| 2008 | Formation of India SME Asset Reconstruction Company Ltd. (ISARC) |
| 2015 | Establishment of Micro Units Development & Refinance Agency Ltd (MUDRA) |
| 2016 | Launch of Trade Receivables Discounting System (TReDS) |
| 2017 | Commencement of Certified Credit Counsellor (CCC) |
| 2018 | Launch of MSME Pulse and CriSidEx |

**Source:** SIDBI, available at https://sidbi.in/en/about-sidbi

Table 2.1 indicates how SIDBI has created infrastructure for the development of MSME sector in our country over the years.

**Scheduled Commercial Banks**

The banking sector in India is dominated by scheduled commercial banks (SCBs). SCBs comprise diverse organizations. According to ownership, we can categorize it as Public sector banks and Private sector banks. In private sector banks, we again have the category of domestic private sector banks and foreign private sector banks. Domestic private sector banks can be categorized and old generation banks and new generation banks.

The practice of private banking is very old in India; in fact, all banks were private initially during pre-independence era. After independence, many private banks were nationalized in two phases. Remaining banks kept functioning as private banks and are called as old generation private sector banks. During liberation process, in 1994, RBI gave licenses to new private banks and they are called as new generation private sector banks.

**Table 2.2:** Type and number of banks (as on, 31st March, 2020)

| Type of bank | Number of banks |
|---|---|
| Public Sector Banks (PSBs) | 20 |
| Private Domestic Banks | 22 |
| Private Foreign Banks | 44 |
| Small Finance Banks (SFBs) | 10 |
| Payment banks | 7 |
| Regional Rural Banks (RRBs) | 45 |
| Local Area Banks (LABs) | 3 |

**Source:** RBI available at https://www.rbi.org.in/scripts/banklinks.aspx

Till 2015, RBI used to issue licenses to only universal banks i.e. banks offering all kinds of banking products/services. However, after 2015 RBI has started giving licenses to specialized/differentiated/niche banks alongside the universal banks. We have Small Finance Banks and Payment Banks operating as niche banks in the country. RBI gave license to 10 Small Finance Banks with an idea that they will provide saving facilities and supply credit to small and marginal farmers, MSMEs and unorganized. The focus of these banks should be to use technology, and to emphasize RBI also demanded a detailed technology plan from these SFBs. The model tries to reduce the shortcomings of geographical restrictions for RRBs and LABs by having the provision that these banks can operate pan India.

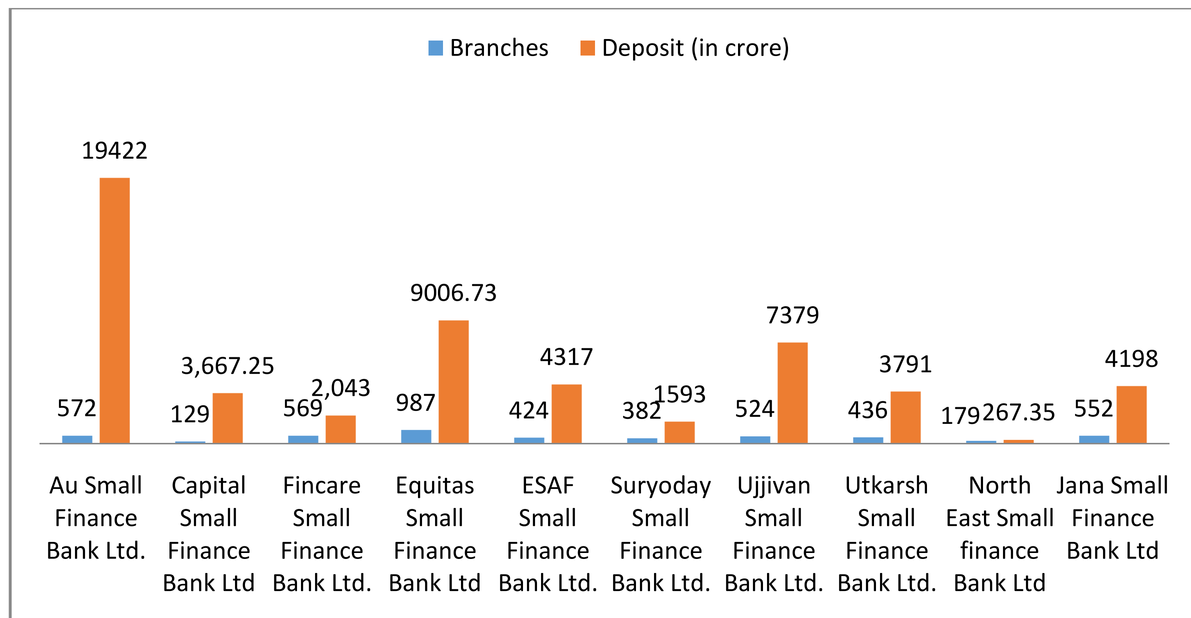



**Figure 2.5:** Number of branches and deposit of SFBs as on March, 2019 | **Source:** Annual report of respective SFBs

The minimum paid-up capital for these SFBs were Rs. 100 crore and SFBs having net worth of more than Rs. 500 crore should get listed within three years. They need to comply with all the norms just like SCBs. To emphasize their focus in the rural area, RBI has mandated them to spend 75 % of adjusted net bank credit to priority sector. Another indicator of its focus on financial inclusion is: out of 10 licenses provided; eight are given to MFIs, one to LAB and one to NBFC. Their performance in terms of outreach and deposits can be seen in the figure 2.5. Here, Au Small Finance Bank is leading in deposits with Rs. 19422, which is more than double of its closest competitor Equitas Small Finance Bank having maximum number of branches. RBI also gave license to seven payment banks. They are mainly technology or Telecommunication Company. Unlike, SFBs, where focus is on serving the unbanked, Payment banks can serve both the end of society. Restriction of the products being offered is limiting its growth in our country.

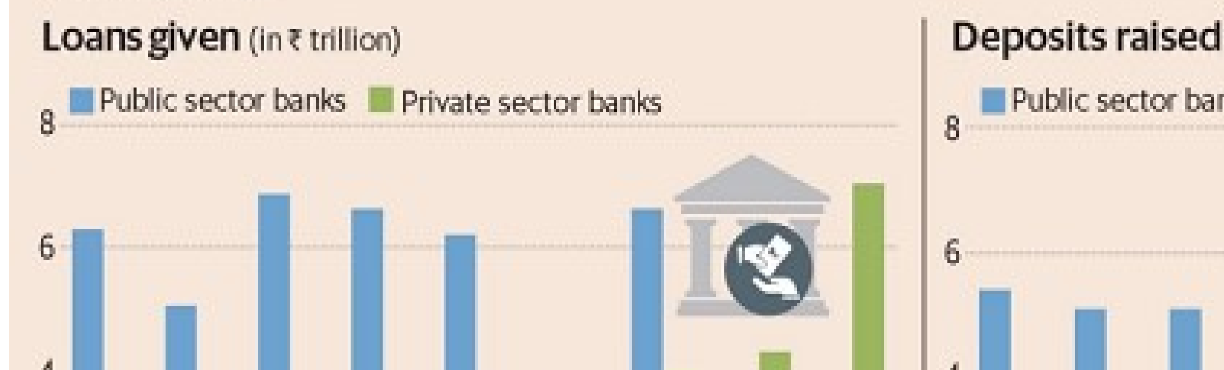


**Figure 2.6**: Loan given and deposit raised by public and private sector banks | **Source:** Centre for Monitoring Indian Economy taken from **Kaul** (2019)

In 2019, loan given and deposit raised by private sector bank was Rs. 7.3 trillion and Rs. 7.1 trillion respectively, whereas public sector banks gave Rs. 2.3 trillion loan and raised Rs. Deposit worth Rs. 2.7 trillion. The government has the provision of priority sector lending for these banks, wherein they need to lend 40 percent of their Adjusted Net Bank Credit or Credit Equivalent Amount of Off-Balance Sheet Exposure, whichever is higher in the priority sector. These priority sectors have been defined by the government. There are even targets for sub-categories defined such as agriculture, micro enterprise, and weaker section of the society within the priority sector. The foreign banks with less than 20 branches have been exempted from the targets for sub-categories, but they also need to lend 40 percent for the priority sector.

In an effort to develop rural economy, government started Regional Rural Banks (RRBs) were established in 1975, to provide timely access to credit to the rural people especially economically and socially marginalized population. The idea was to complement the presence of commercial banks and cooperative banks. RRB has the equity from central government, state government and sponsoring bank in the proportion of 50, 15 and 35 respectively. The idea behind RRB was to bring the equity of cooperative and professionalism of banks together. But it did not give the desired result, because their area of operation was restricted, sponsoring banks started simply replicating their practices here, branches were opened in the banked area, unable to earn the trust of customers for depositing their money, unwillingness to staffs for local involvement and lengthy process of credit facility.

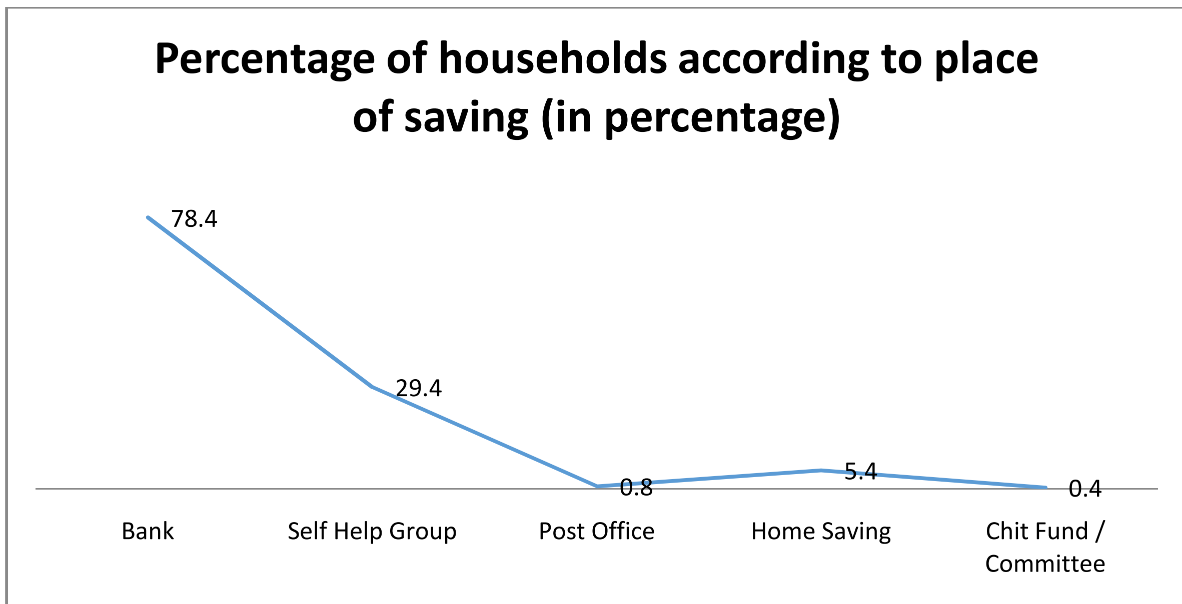
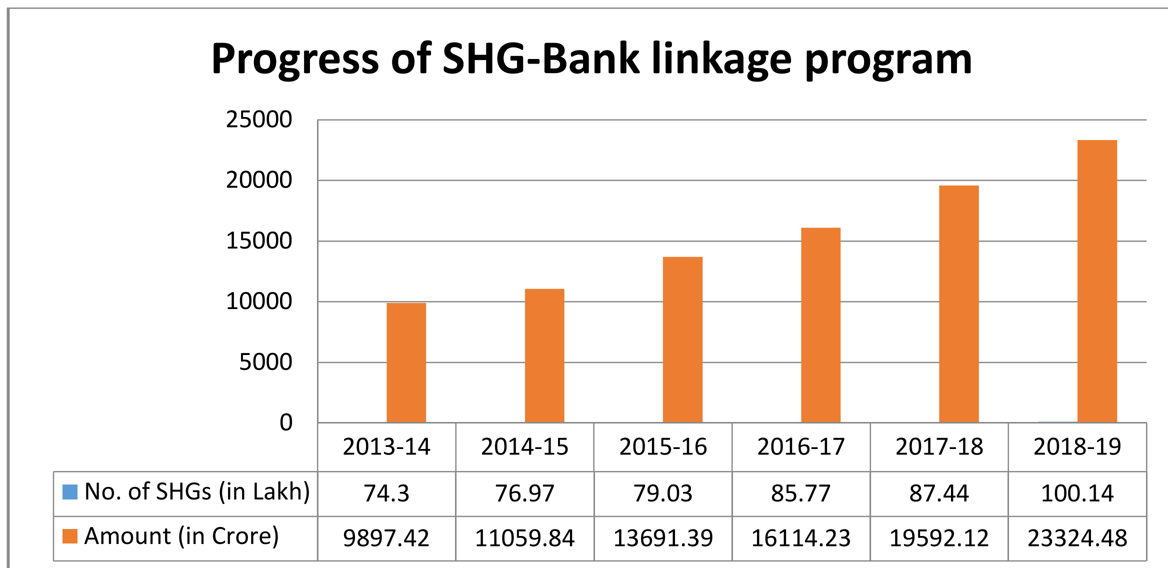



**Figure 2.7**: Place of Savings | **Source:** NAFIS, 2017

In addition, government has initiated self -help group-bank linkage program, where banks provide financial services to the self-help groups (SHGs). One can see the importance SHG from figure 2.7, when it comes to place of saving by the consumers. Figure 2.8 shows the growth of SHGs in terms of number as well as amount over the years.

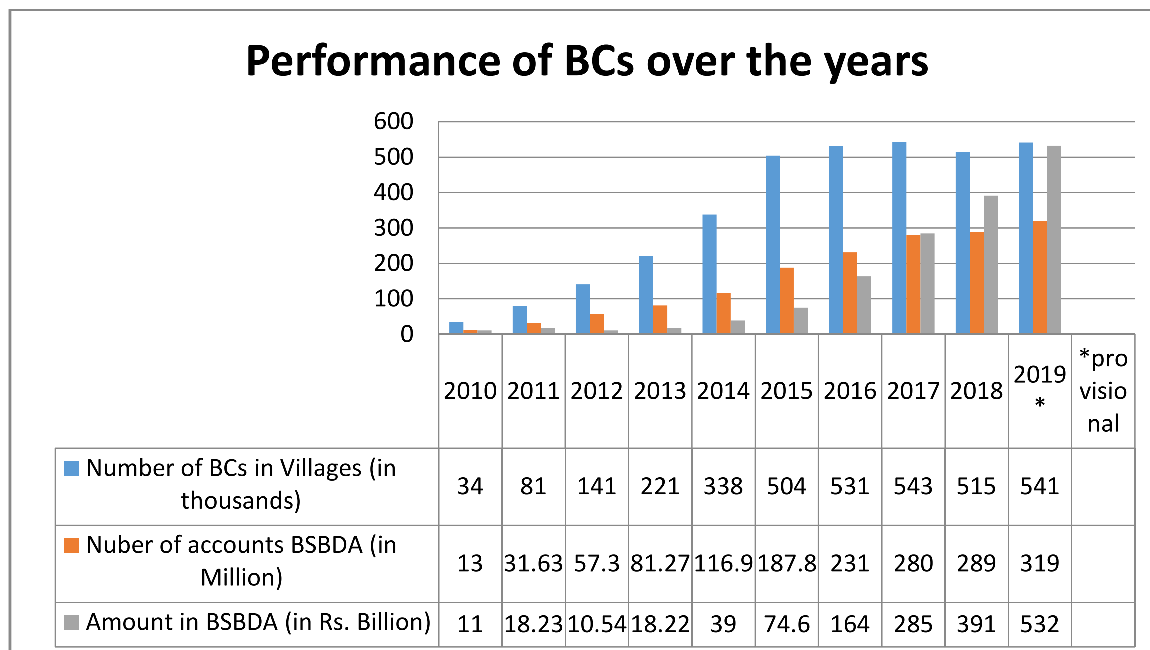



| | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 |
|---|---|---|---|---|---|---|
| No. of SHGs (in Lakh) | 74.3 | 76.97 | 79.03 | 85.77 | 87.44 | 100.14 |
| Amount (in Crore) | 9897.42 | 11059.84 | 13691.39 | 16114.23 | 19592.12 | 23324.48 |

**Figure 2.8** Progress of SHG-Bank linkage program | **Source:** Status of Microfinance by NABARD 2018-19, 2017-18, 2016-17, 2015-16

In addition, to decrease the number of unbanked people, **Business Correspondents (BCs)** model was adopted, where organization/individual was allowed to provide credit/deposit service on behalf of banks. Given the number of people financially excluded in our country, RBI has promoted BC model as branchless banking model, which still provide physical access to the customers. The services are being outsources to third party, which could be either static or mobile in nature. Another prominent feature of this model is use of technology. Here, banks will appoint BC and take full responsibility of

the act of these BCs. Each BC is attached to one branch, which takes care of its supervision and monitoring.




| | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 * | *provisional |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Number of BCs in Villages (in thousands) | 34 | 81 | 141 | 221 | 338 | 504 | 531 | 543 | 515 | 541 | |
| Nuber of accounts BSBDA (in Million) | 13 | 31.63 | 57.3 | 81.27 | 116.9 | 187.8 | 231 | 280 | 289 | 319 | |
| Amount in BSBDA (in Rs. Billion) | 11 | 18.23 | 10.54 | 18.22 | 39 | 74.6 | 164 | 285 | 391 | 532 | |

**Figure 2.9:** Performance of BCs over the years | **Source:** Annual Report of RBI 2014, 2015, 2016, 2017, 2018, 2019

**Scheduled and non-scheduled state Cooperative banks**

To reduce rural indebtedness and poverty, rural cooperative banks were envisaged. They have the provision for providing short term as well as long term loans. With its root in the rural area, they continue to play an important role in providing credit to rural people leading towards increased productivity in the agriculture as well as non-agriculture sector. Cooperative institutions also help in ensuring food security; another pertinent issue in today's world, where we see the irony of people dying from hunger in spite of producing enough food. They have also helped in generating employment opportunities for the rural poor and facilitated the socio-economic justice for these people in distress. There are 33 scheduled and 10 non-scheduled state cooperative banks operating in the country.

**Non-scheduled banks**

Under non-scheduled banking system, we have local area banks (LABs). LABs were conceptualized as low-cost structure and introduced in 1996 for providing efficient and effective financial intermediation services to the people living in rural and semi-urban area. They were expected to bring the efficiency of private sector in rural financing. The idea was to mobilize the rural saving and make it available for the investment in the same area. Operating area of LABs is limited and covers three adjoining districts mainly catering to rural and semi-urban population. These non-scheduled banks are not listed in the 2$^{nd}$ schedule of the RBI act, have less than Rs. Five lakhs as reserve capital, and they cannot borrow from RBI under normal circumstances. These restrictions have limited the ability of these non-scheduled banks to compete in the market and over the years their numbers have reduced.

**Non-Banking Financial Companies (NBFCs)**

NBFCs are companies registered under the Companies Act, 1956. They can lend money as well make investments; however, they cannot perform following activities, which differentiate them from banks: 1) acceptance of demand deposits, 2) part of payment & settlement system and issuing cheques and 3) facility of deposit insurance and credit guarantee corporation.

They can be categorized as deposit taking and non-deposit taking based on their liability structure. In addition, they can also be categorized based on activity as: 1) Investment and Credit Company, 2) Housing Finance Companies, 3) NBFC-Infrastructure Finance Company, 4) NBFC–Peer to Peer Lending Platform, 5) NBFC-Systemically Important Core Investment Company, 6) NBFC-Account Aggregator, 7) Infrastructure Debt Fund-NBFC, 8) Mortgage Guarantee Company, 9) NBFC-Non-Operative Financial Holding Company, 10) NBFC-Factor and 11) NBFC-Micro Finance Institution. Here, we need to take a note that all NBFCs are not regulated by RBI, based on the activities they are in, their regulators are different as shown in Table 2.3.

**Table 2.3:** Type of NBFCs and regulating bodies

| Type of NBFCs and regulating bodies Regulator | |
|---|---|
| NBFCs registered with RBI | Reserve Bank of India |
| Housing Finance Institutions | National Housing Bank |
| Merchant Banking Company, Venture Capital Fund Companies, Stock Broking, Collective Investment Schemes | Securities and Exchange Board of India |
| Nidhi Companies, Mutual Benefit Companies | Ministry of Corporate Affairs |
| Chit Fund Companies | State Governments |
| Insurance Companies | Insurance Regulatory and Development Authority |

**Source:** RBI, available at https://www.rbi.org.in/Scripts/FAQView.aspx?Id=92

NBFCs have performed well in their duty of contribution towards the development on Indian economy especially rural economy. Their focus remains on provide credit facilities to industries especially those who remain left out by the banks.

**Table 2.4: Distribution of NBFC credit**

| Distribution of NBFC credit (in percentage) | | | | |
|---|---|---|---|---|
| | **2016** | **2017** | **2018** | **2019** |
| **Industry** | 61.2 | 60.2 | 52.3 | 56.7 |
| **Retail Loans** | 15.6 | 16.8 | 22.1 | 20.2 |
| **Services** | 14.2 | 15 | 18 | 14.5 |
| **Others** | 6.1 | 5.7 | 4.6 | 6 |
| **Agriculture and Allied activities** | 2.9 | 2.3 | 3 | 2.6 |

**Source:** Report on Trend and Progress of Banking in India: 2017, 2018, 2019

NBFCs also comprises insurance companies, chit fund companies, housing finance companies, mutual benefit companies as shown in table 2.3 and each one of them have very high importance in the rural area. Chit fund companies are regulated by state governments and their main clientele is poor people, so it regulation/supervision is very crucial, especially in the present context when we

keep on hearing the news about the wrong activities of these companies. The housing especially affordable housing is an area, where India has lot of potential and National Housing Bank (NHB) can play a huge role in making sure that people get their own house. The penetration of insurance in our country is very low, and situation is worse in rural area. Multiple stakeholders need to take concentrated effort to increase the penetration of insurance. We have farmers taking high risk in farm activities and insurance would be handy dealing with risk. Insurance companies have devised micro-insurance product for poor people but it has not provided the desired result. The reasons behind its lower intake are from supply as well as demand side. From supply side, we are facing the issues like lack of appropriate products, reluctance of employees to work in the rural area, absence of organizations, and low incentive for the agents/organization. Demand side factors are like low level of literacy, lack of trust in the organization, not knowing the importance of insurance etc.

## 2.4 Co-operative Banking- Three Tier System of Lending

Indian cooperative banking system operates on three-tier/two tier structure. Rural cooperatives can be classified based on time dimension i.e., providing short term and long-term financial services. Under long term, we have two tier structures of State Co-operative Agriculture and Rural Development Banks (SCARDBs) and Primary Co-operative Agriculture and Rural Development Banks (PCARDBs). And, under short term, we have three tier structures of State Co-operative Banks (StCBs), District Central Co-operative Banks (DCCBs) and Primary Agricultural Credit Societies (PACS). In terms of assets, short term cooperatives dominate and comprise 94.2 percent of total assets of rural cooperatives as of 2018.

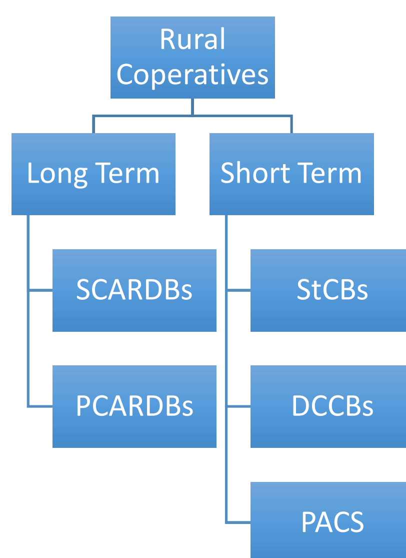



**Figure 2.10**: Structure of rural cooperatives | **Source:** RBI

While structure of short-term rural cooperative as shown in figure 2.10 is largely followed across the state, same is not the case for long-term rural cooperatives. In some states long-term rural cooperatives follow unitary structure i.e., only SCARDBs operate, whereas in certain places they follow federal structure i.e. operate through PCARDBs with SCARDBs as apex body, and in certain places they follow mix structure i.e. operating through branches of both SCARDBs and PCARDBs.

**Table 2.5:** Structure of long-term rural cooperatives in different states

| Structure of long-term rural cooperatives in different states | |
|---|---|
| **Number of states** | **Structure of long-term cooperative** |
| 5 | Unitary |
| 6 | Federal |
| 2 | Mix |

**Source:** RBI, Report on Trend and Progress of Banking in India: 2019

The share of these cooperatives in providing agriculture credit has decreased over the years but they are still relevant and important player.

**Table 2.6: Agency-wise share in total agricultural credit**

| Agency-wise share in total agricultural credit (in percentage) | | | | |
|---|---|---|---|---|
| **Institution** | **1981** | **1991** | **2001** | **2017** |
| **SCBs** | 41 | 54.5 | 57.3 | 79 |
| **RRBs** | 3.2 | 6.4 | 10.5 | 5 |
| **Cooperatives** | 55.8 | 39.1 | 32.2 | 15 |
| **MFIs** | | | | 1 |

**Source:** NAFIS, 2017

As shown in table 2.7, one can see the importance of cooperatives in terms of reach in the rural India.

**Table 2.7: Number, deposits and borrowings of short-term rural cooperatives**

| Number, deposits and borrowings of short-term rural cooperatives | | | | | | |
|---|---|---|---|---|---|---|
| | **State Cooperative Banks (StCBs)** | | **DCCBs** | | **PACs** | |
| | **2017** | **2018** | **2017** | **2018** | **2017** | **2018** |
| **Number of banks** | 33 | 33 | 370 | 363 | 93367 | 95595 |
| **Deposits (in crore)** | 122038.6 | 123534.1 | 330904 | 347967 | 101065 | 115884 |
| **Borrowings (in crore)** | 80892.52 | 72169.95 | 91438 | 90312 | 112690 | 124831 |

**Source:** Source: RBI, Report on Trend and Progress of Banking in India: 2019

In addition, Kisan Credit Card (KCC) scheme started by government to provide timely institutional credit to farmers is being implemented through these cooperative banks. The scheme provides credit to farmers for their agriculture related needs as well as it also covers the needs of people involved in animal husbandry and fishery activities.

The cooperative banks are operating on the equity funds of its own members, this result in resource constraint for them. Further, bad loans, inability to recover the loan, political interferences, and dominance of big farmers have acted as hindrance for cooperatives banks to reach its potential.

## 2.5 Micro Finance Institutions (MFIs) –JLGs- Farmers clubs- Farmer producer Organizations (FPOs)

**Micro Finance Institutions (MFIs)**

MFIs are one of the important institutions providing credit to poor people. Their presence is equally important in rural as well as urban area, as poverty is present irrespective of geographical classification. The share of the MFIs (as shown in figure 2.11) in micro-credit sector during 2019, is noteworthy and needs the attention of concerned stakeholders to strengthen its presence in the sector. They are the biggest players with a share of 38 percent, followed by banks and SFBs.

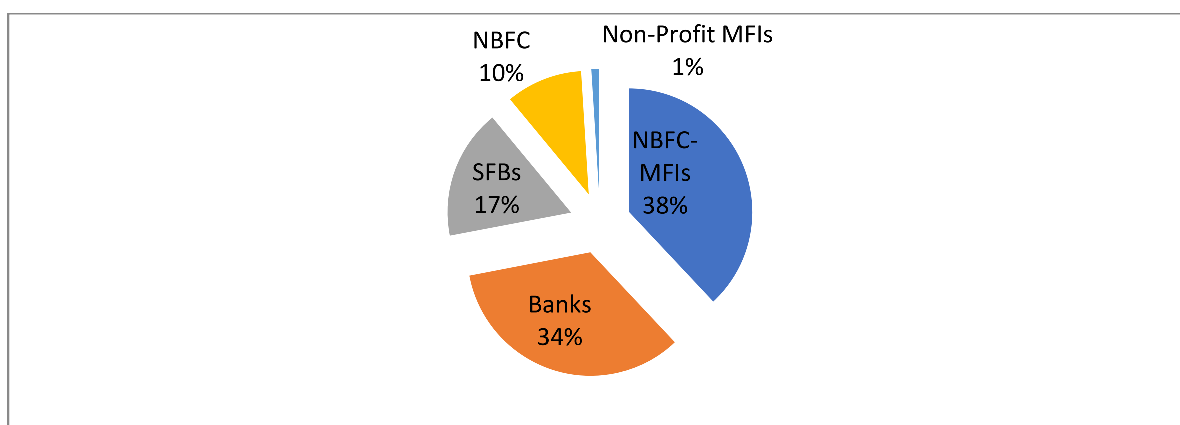
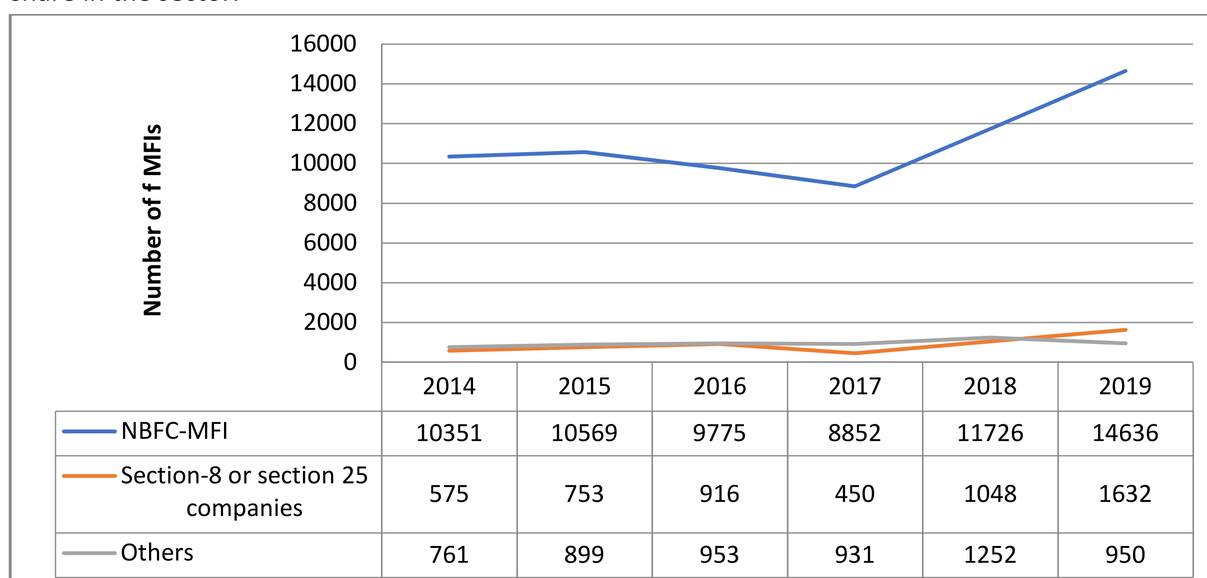



**Figure 2.11:** Market Share in Loan Portfolio Outstanding in 2019 (in percentage) | **Source:** The Bharat Microfinance Report- 2019

MFIs are a set of diverse types of organizations; they work under different legal structure. Majority of them operates as NBFC-MFIS, whereas, we have MFIs registered with section-8, societies, cooperatives and trusts. They are very important for implementing financial inclusion agenda of the government. The microfinance sector is dominated by NBFC-MFIs (see figure 2.12), with majority of the share in terms of client's outreach as well as loan portfolio going to them. Further, MFIs having portfolio of more than Rs. 500 crores dominate the market and have more than 80 percent of the share in the sector.




| | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|---|
| NBFC-MFI | 10351 | 10569 | 9775 | 8852 | 11726 | 14636 |
| Section-8 or section 25 companies | 575 | 753 | 916 | 450 | 1048 | 1632 |
| Others | 761 | 899 | 953 | 931 | 1252 | 950 |

**Figure 2.12:** Number of different types of MFIs over the years | **Source:** The Bharat Microfinance Report-2014, 2015, 2016, 2017, 2018 and 2019

These MFIs are not uniformly distributed across the different geographical region of the country (see figure 2.13). Here, south leads with maximum number of clients followed by east. The penetration of MFIs in north and north-east is very minimal and not even in double digit.

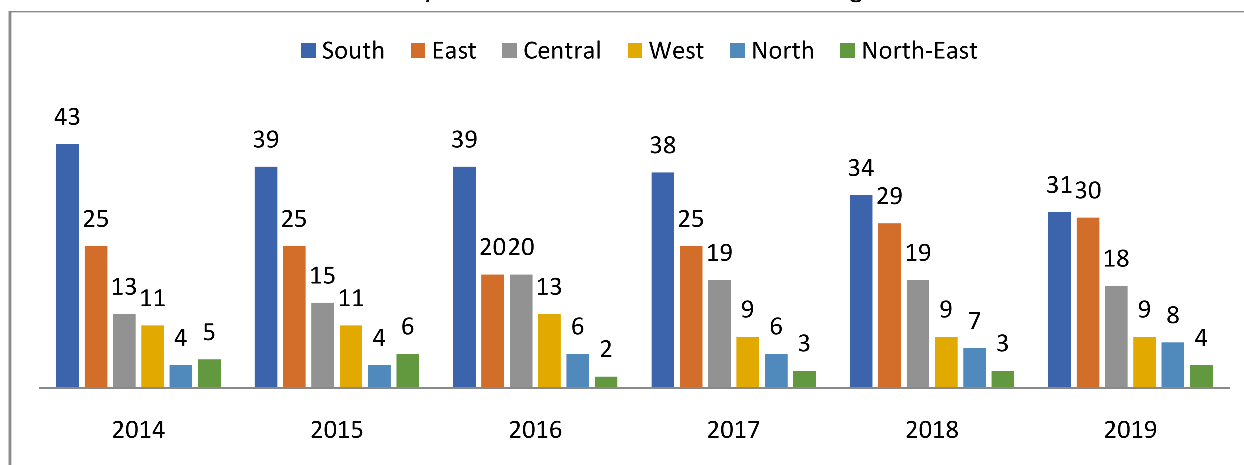



**Figure 2.13:** Regional break up of Client Outreach (in percentage) | **Source:** The Bharat Microfinance Report-2014, 2015, 2016, 2017, 2018 and 2019

Majority of these MFIs are operating through Joint Liability Groups (JLGs). The idea of using JLGs and its benefit is quite evident with the success of these MFIs. They have very high level of repayment because of the joint liability of the group. Given the limited access to credit from other organized players, members make sure that the loan is repaid within the time period given by the MFIs.

The importance of MFIs also can be seen through the kind of clientele they are dealing with (see table 2.8), its presence on weaker section of the society is praiseworthy and perhaps they are fulfilling the mandate of reaching to the unbanked and serving the under-privileged.

**Table 2.8: Performance of MFIs over the years**

| Performance of MFIs over the years | | | | | | | |
|---|---|---|---|---|---|---|---|
| | **2013** | **2014** | **2015** | **2016** | **2017** | **2018** | **2019** |
| **Number of branches** | 10697 | 11687 | 12221 | 11644 | 10233 | 14026 | 17218 |
| **Number of clients (in lakh)** | 275 | 330 | 371 | 399 | 295 | 351 | 429 |
| **Women clients (in %)** | 96 | 97 | 97 | 97 | 96 | 96 | 99 |
| **SC/ST clients (in %)** | 21 | 19 | 28 | 30 | 20 | 33 | 32 |
| **Rural Clients (in %)** | 67 | 56 | 33 | 38 | 61 | 55 | 55 |
| **Gross Outstanding Portfolio (in Crore)** | 25738 | 33517 | 48882 | 63,853 | 46,842 | 68,789 | 94,391 |

**Source:** The Bharat Microfinance Report-2014, 2015, 2016, 2017, 2018 and 2019

**Farmers Clubs**

Seeing the importance of agriculture sector in India, NABARD started the idea of farmers club in 1982 to improve the productivity of this sector holistically by providing inputs from multiple stakeholders. The idea initially named as "Vikas Volunteer Vahini" and later in 2005 got renamed as farmers' club program. The minimum number to start a farmers club is 10 farmers and there is no upper limit for number of members in the club. It is an informal organization, which can be

organized by banks, NGOs, Krishi Vigyan Kendras etc. The program aims to create win-win situation for all the stakeholders. NABARD gives monetary support of Rs. 12,000 per annum for a period of three years to one club. The monetary support is meant for covering maintenance expenses, organizing workshops, facilitating the meeting with experts and capacity building activities. In addition, promoting NGOs also get an honorarium of Rs. 3,000 to Rs. 6,000 per year for a period of three for one club. They get this monetary support to handhold and guide the farmers club.

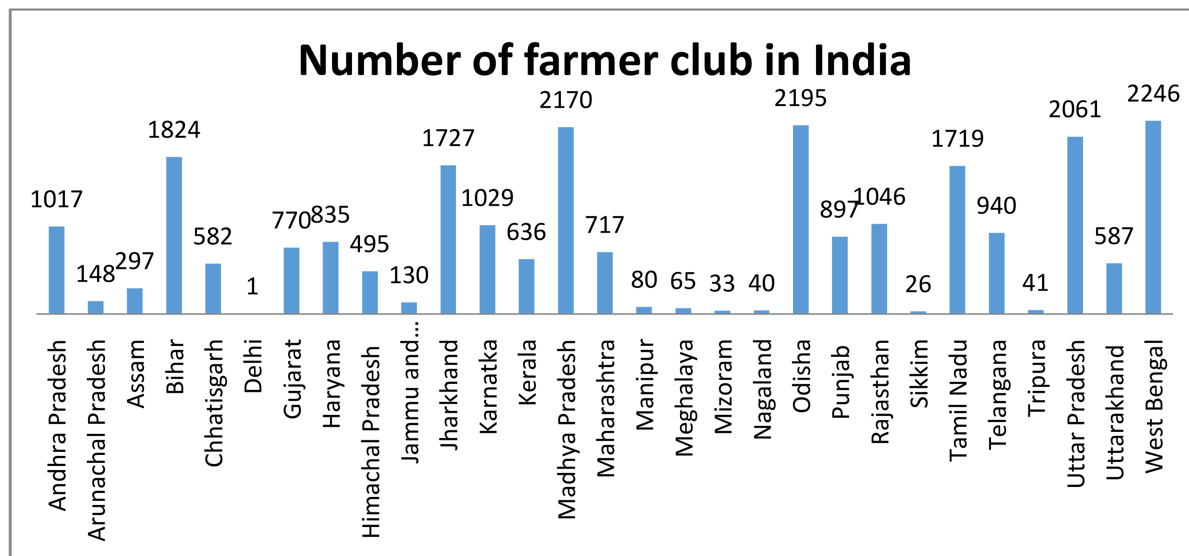



**Figure 2.14:** Number of farmer club **| Source:** https://www.krishaksarathi.com/map.php?type=fc

Although, the core of the program was 'development through credit', it has various others inputs essential for the agriculture sector starting from providing high-yield seeds to marketing of produce. It aims not only to promote technology but also adoption of it. The program is aimed to promote community mobilization and build the skills of framers. There are 24354 farmers clubs in our country in 2019.

**Farmer Producer Organizations (FPOs)**

The cooperatives as a form of business organization were developed for enabling the farmers to improve value chain and to scale up the business. However, cooperatives in India have adopted certain practices that have defeated the purpose of cooperatives and have weakened the framework except for some cooperatives dealing in commodities like milk and fertilizers. One of the major reasons for less success of these movements could be ascribed to lack of professionalism in managing the affairs of these organizations. In order to address organizational issues of the cooperatives, Companies Act 1956 was amended in 2002 which enacted formation of 'Producer Companies'. It is a hybrid organization which combines good features of both the organizational structures namely cooperatives and limited companies.

Agriculture is still a major contributor to the Indian economy. With the increasing trend of government withdrawal from the sector, it becomes imperative to provide a sustainable form of organizational structure for farmers to sustain and compete with private sector players. The condition of Indian farmers is different from that of farmers of other countries' farmers primarily because of small land holding and in this situation; coming together is the only solution for them to avail the benefits like economies of scale and market opportunities.

As of now there are different types of FPOs, providing various types of facilities to the members (See figure 2.15).

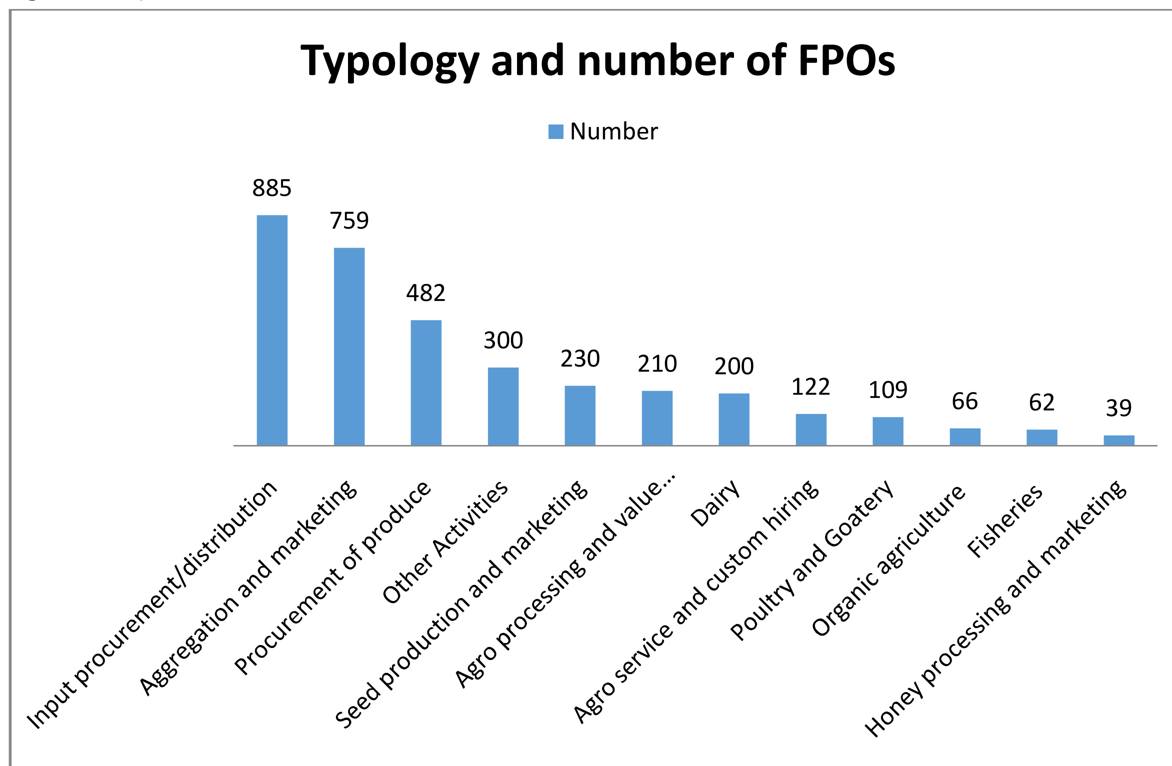



**Figure 2.15:** Typology and number of FPOs

These FPOs are trying to address the long-pending issues related to agriculture and allied sector. As it can be seen from the figure 2.15, maximum numbers of FPOs are engaged in procurement, distribution and marketing related activities. We know how farmers are facing problems in terms of getting access to inputs required as well as marketing their produce. The issues have further aggravated because of involvement of small and marginal farmers, and these FPOs are showing the way to resolve these problems.

There are special schemes like 'Producers organization Development and Upliftment Corpus' Fund, having the provision of Rs. 2,000 crore to help the FPOs. The fund is meant to support financially as well as non-financially especially during the formative times of these FPOs. While they are in formative stage, they need support like capacity building, awareness creation etc..Under this fund, NABARD helps them through this fund. In addition, Producers Organization Development Fund is also being utilized to promote the FPOs. This fund is need based grant support for these organizations. NABARD provides support in capacity building, market linkage, help in making planning report, covers some administrative costs, credit guarantee facility and incentive for promoting agency.

**Summary**

Indian rural financial landscape comprises institutional as well as non-institutional players. The informal sources or non-institutional players include friend/relatives, moneylenders (landlord/input-suppliers) and Rotating Savings and Credit Associations (ROSCAs). In institutional players, banks

dominates the field, but we also presence of organizations like India post providing financial services to the rural India.

Under banking system, we have the presence of regulator i.e., Reserve Bank of India, Development Finance Institutions (NABRAD /SIDBI), scheduled and non-scheduled banks as well as scheduled and non-scheduled cooperative banks. Here, scheduled banks have major share in the financial market. Under, scheduled banks, we have the presence of public sector banks and private sector banks. Public sector banks are nationalized banks owned by the government. In private sector, there are domestic private banks and foreign private banks. Presence of foreign private banks is mostly in urban area. In domestic private banks, there are old generation private and new generation private banks. Under new generation banks, RBI has permitted licenses to Small Finance Banks and Payment Banks to increase the presence of formal organization in rural area. In addition, we have also have presences of no-banking financial companies in the rural area. Here most noteworthy is the presence of micro-finance institutions working through JLG to provide access to credit to unbanked.

## Model Questions

1. Discuss the importance of informal (non-institutional) financial players.
2. Analyze the role of NABRAD and SIDBI for the development of rural area.
3. "Scheduled commercial banks are very important players in the rural financial landscape", comment on the given statement.
4. Why cooperative banks are important for rural financial system?
5. How Farmer Club and Farmer Producer Organizations are playing an important role for the rural people in our country?
6. Discuss about the different types of Non-Banking Financial Companies.

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# Chapter 3 Rural Banking

## Introduction

Rural banking ensures the flow of credit to the rural economy through a multi- agency approach. These multiple agencies are - Commercial Banks, Co-operative Banks and Regional Rural Banks. These banks provide short term, medium term and long-term loan. The short-term loans or crop loans are most prominent because it is availed by marginal and small farmers who form the major portion of the farming community. One of the modes of disbursal of crop loan is through Kisan credit Card which ensures that the credit is available to the farmer immediately when he needs it. It is a fast mode of disbursing short term credit to farmers so that they can purchase the agricultural inputs on time.

Among the multiple agencies, co-operatives are the most widespread channel for delivering rural credit, especially the crop loans. The short-term co-operative credit structure comprises of three layers – Primary Agricultural Co-operatives at village level, District co-operative Banks at district level and State Co-operative banks at state level. Though co-operatives have a robust outreach, they have not lived up to the expectation in terms of delivering agricultural credit because of lack of professionalism, poor governance structure, restrictions on operational area and limited choice of product.

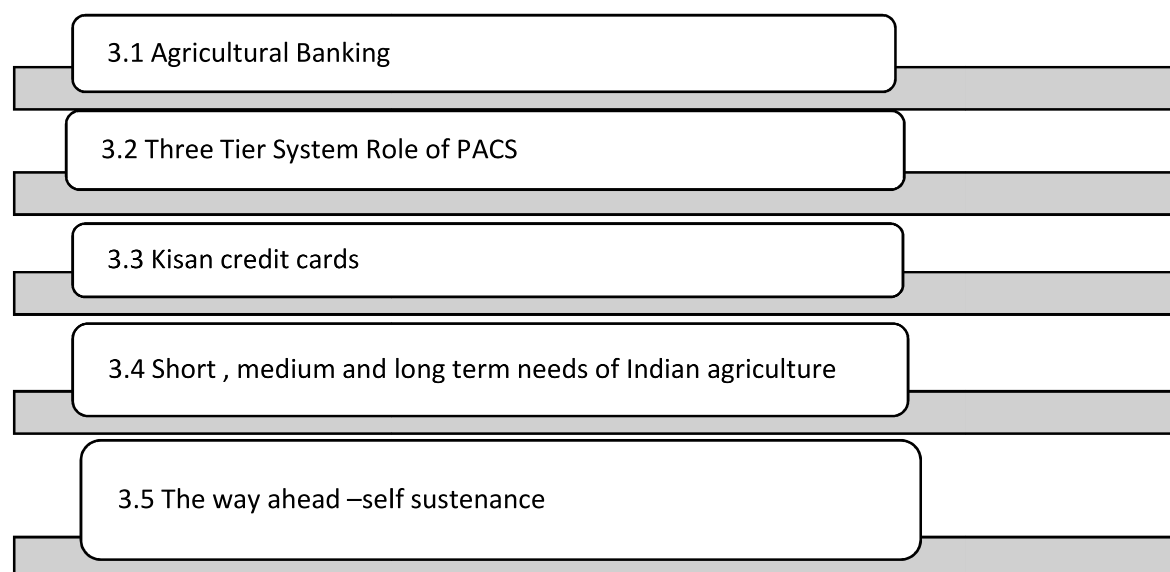
Credit is not the only aspect which drives agricultural productivity. There are other requirements like access to quality inputs, access to market, and access to technology which if provided along with credit, can bring prosperity to the farm sector. Commercial Bank, Cooperative Banks and Regional Rural Bank are the pillars for delivering credit to the remote areas but each of them has their own share of achievements and pitfalls. Like every institution, they also possess some strengths and some weaknesses but overall, each of them has immensely contributed to rural prosperity.

## Objective

The objective of this chapter is to familiarize the students with the functioning of the Rural banking network and flow of rural credit across the country. It also covers the other needs of the farm sector transcending the credit needs- like availability of various inputs like seeds, fertilizers, pesticides and facilities like irrigation, mechanization etc. The goal of this chapter is to:

- To familiarize the students about short term credit facility and term loan available to farmers
- To acquaint them with different channels of credit delivery
- To give them an overview of the three-tier co-operative structure
- To familiarize them with crop loan disbursal through Kisan Credit Card
- To help them appreciate the strengths and weaknesses of each channel of credit delivery
- To make them conversant with other needs of farmers beyond credit, which are important for effective utilization of credit

**Structure**




## 3.1 Agricultural Banking

Agriculture is an important sector for the Indian Economy. It employs more than half of the working population and provides food security to the country. The term agriculture and allied activities broadly refer to crop production, rearing livestock, forestry and pisciculture. The policies and actions of the Government caused the green revolution in late sixties to early eighties, followed by white revolution in the early seventies boosting milk production and blue revolution from 1973-2002 which increased fish production. Such growth would not have been possible without the liberal flow of Credit to the agriculture sector.

Thus, All India Rural Credit Survey Committee (AIRCSC) created the first framework for an efficient credit delivery in rural areas which was later known as multi-agency approach. The AIRCSC, (1951-54) was asked by the government to evaluate the performance of co-operative. They found that most co-operatives were burdened with over dues leading to erosion of capital so they suggested that commercial banks should also support the co-operatives in delivering rural credit. Before that the cooperative structure was solely responsible for disbursing farm credit. The cooperatives were poorly capitalized and not able to meet the burgeoning credit demands of the farmers resulting from the capital-intensive Green Revolution. To supplement the effort of Cooperative Banks in increasing credit flow to the rural areas, commercial banks were nationalized in 1969 and 1980. Further, in 1976, Regional Rural Banks were set up as alternative agencies focused on providing only rural credit. These multiple agencies increased the flow of institutional credit to the farm sector during late seventies and eighties. The rural reach of the banks increased leaps and bounds and as a consequence, the farmers' credit requirements gradually shifted from the informal to the formal sources of credit. The Commercial Banks, Cooperative Banks and Regional Rural Banks became the three agencies for disseminating credit in rural locations.

During this period the Lead Bank Scheme and Priority Sector Lending regulations were also introduced. The former initiated the bottom-up approach of credit planning while the latter marked the beginning of directed lending, both of which are applicable till date.

Priority sector lending regulations direct the banks to provide loans to those sectors and segments which were hitherto deprived of credit facilities though they needed it the most. The banks were directed to give forty percent of total loans disbursed during a year to the sectors which have been categorized for priority lending. The eligible activities under priority sector lending include loan given for crop production, building agro-infrastructure and for ancillary activities

**Crop Loan System**

Crop loan system forms a part of the farm credit. It is the loan given to farmers for Seasonal Agricultural Operations. It covers all the expenses incurred by the farmer starting from preparation of land for sowing till marketing of the crop. These expenses are incurred seasonally and are recurring in nature.

The crop loan is normally required for 3-4 months but often it gets stretched by another two months to provide time for post- harvest activities and marketing of the crop. For long duration crop like sugarcane or banana the tenure of loan provided is one year to 18 months. The maximum period for a crop loan is up to 18 months. The crop loan is availed from Institutional as well as Non-Institutional sources. The non- institutional sources include relatives and friends, input suppliers, landlords and moneylenders.

When we refer to institutional sources there are three agencies which deliver rural credit namely, the commercial banks, co-operative banks and regional rural banks. In the annual budget Government allocates target for agricultural credit to each category of bank against which the performance is measured. The overall target has been achieved during 2017-18 and 2018-19 as seen in **Figure 3.1**. However, Cooperative Banks as a category have failed to achieve the target since last two years. Commercial banks lead the disbursement of agricultural credit and they have over-achieved the target.

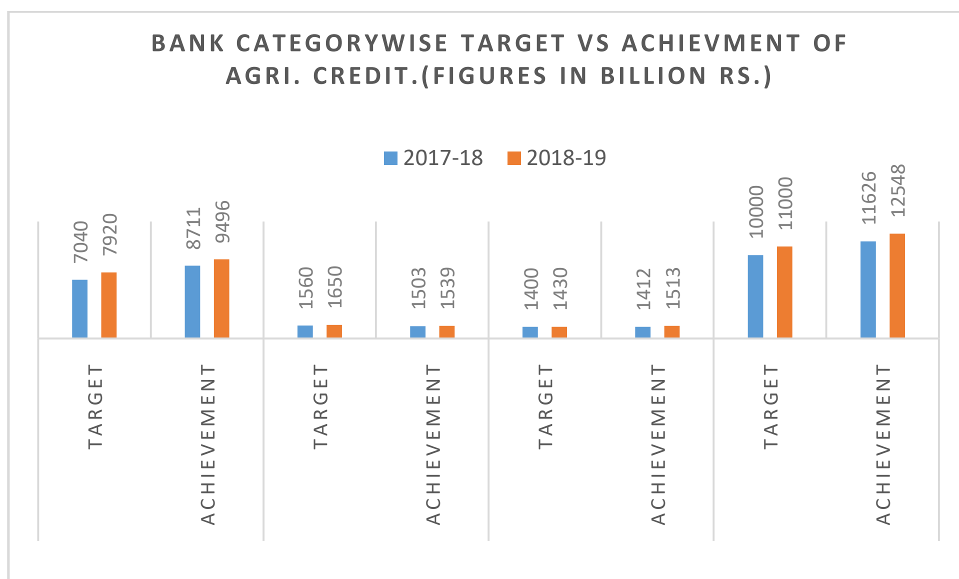



**Figure 3.1:** Bank Category-wise Target Vs Achievement **| Source:** RBI annual report 2019

The crop loan is provided to meet the cost of cultivation which depends upon the type and variety of crop, area of cultivation, technology and inputs used and other factors. However due to high turnover and to avoid complexities, the loan eligibility is calculated and fixed based on area

of cultivation and type of crop. In other words, the loan per unit area which is called the scale of finance is fixed for different type and varieties of crop. There is a technical committee comprising of representatives from stake-holding institutions like - District Central Cooperative Bank, major commercial banks, State Government Agriculture departments, Primary Agriculture Cooperative Society and farmers. The scale of finance is different for irrigated and non-irrigated areas.

**Eligibility of Crop Loan**

The crop loan may be availed by following categories of cultivators:

a. Farmers, who are owners and cultivators;
b. Lease Hold and tenant farmers who cultivate the land but do not own it.
c. Self Help Groups (SHGs) or Joint Liability Groups (JLGs) comprising of farmers as members. The group may include tenant farmers and share croppers apart from owner cultivators.

**Unique Features of Crop Loan**

**I.** Financing the cultivators who are not land-owners-The loan eligibility and the loan amount is based on size of land holding and crops grown and not on land ownership so tenant farmers and share croppers can be financed in case of crop loan. Having title to the land is not essential.

The sanctioning bank authority has to be satisfied about the authenticity of the applicant's claim that he is carrying out agricultural activity, subject to providing an affidavit stamped and attested by notary public mentioning the terms and conditions of the tenancy. The applicant should provide proof of residing at the place for at least two years. The applicant also has to provide proof of identity for which he may submit any one of the following documents:

A. House ownership or house rent documents
B. Voter's list/Identity Card
C. Any other locally available relevant document which is acceptable to the bank

The maximum loan given to Tenant Farmers, Share Croppers and Oral lessee should not exceed Rs 50000. Eligibility of the loan is calculated based on Scale of Finance applicable to the particular crop multiplied by area under cultivation. Ten percent is added towards meeting the consumption need and twenty percent towards post-harvest and marketing requirement.

**II.** Margin Money – Scale of finance for every crop (Amount per acre) is fixed and decided net of margin so normally payment of margin money is not applicable. In case, the loan eligibility is calculated based on cost of cultivation of the crop, no margin is stipulated for loan up to Rs 160000. For loans above Rs 160000 a margin of 15 to 25 percent is prescribed depending upon risk prescription.

**III.** Interest Rate – the Interest rate has been deregulated so it varies for different banks. Interest is applied on half yearly basis. The interest rate is generally based on quantum of advance and it is linked to base rate.

IV. Security for crop loan- Since the loan eligibility is fixed based on type of crop and area of cultivation so it may be fairly concluded that the repayment is expected from sale of the crop. The crops are hypothecated to the bank as primary security. Loan eligibility is not based on individual cost of cultivation or on the value of tangible security. RBI has stipulated that no collateral should be taken by banks for agricultural loan up to Rs 160000.

V. In 2006-07 Government came up with interest subvention scheme. Under this scheme crop loan may be provided at subsidized rates for loans up to Rs 300000 for a period of one year at 7 percent per annum (2% subsidy). Further, in case of timely repayment, another 3% additional incentive would be paid which would lower the applicable rate of interest to 4%.

**Refinance of Crop Loan**

State level Apex Banks and District Central Cooperative and Regional Rural Banks are eligible for refinancing from NABARD for the Seasonal Agricultural Operations. It covers such activities, ploughing, sowing, and transplanting applying inputs etc. which are required for raising seasonal crops. NABARD provides refinance of crop loan with the undermentioned objectives:

1. To supplement the resources of Cooperative Bank and Regional Rural Banks (RRBs) for meeting the credit needs of its clientele.
2. Develop a sound structure for credit delivery through RRBs and Cooperative Banks by providing short term refinance NABARD supports the following activities:
   I. Agricultural production and marketing of crops by farmers
   II. Marketing and distribution of inputs like seeds, fertilizer etc.

The recovery performance of crop loan is generally better than loans for other activities and due to its short-term nature, the risk is less and there is high turnover of loan business.

**Financing of Crop Loan through Joint Liability Groups of Tenant Farmers**

Joint Liability Group was the brainchild of NABARD. It was started in 2006 on same lines of Self-Help Groups with the intention to provide the lease hold farmers and non-owner cultivators an opportunity to avail short term credit. Such category of farmers finds it difficult to avail finance from banks. Group Based lending helps the banks in simplifying the documentation process, collecting information about group members through peer reviews and generating better repayment culture through peer pressure.

JLG in rural areas also facilitates pooling of demand for seeds, raw material and other inputs as well as opportunity for sorting, grading and aggregating their produce for better prices. As on 31 March 2019, banks have promoted and financed 50.76 lakh JLGs. Small Finance Banks are also providing group loans for agriculture and allied activities through the JLG model. These loans are given for 24 months for cattle purchase, sericulture, equipment purchase, tractor purchase etc.

**Objectives of Providing Crop Loan to JLG**

1. To increase credit flow to farmers who do not possess title to the land.
2. To extend loans without physical security based on social collateral
3. To build confidence between bank and tenant farmers

**Criterion for Forming a JLG**

Normally four to ten individuals come together to form a joint liability group for availing loan. Loan is either disbursed to individual group member or to the entire group against mutual guarantee. All the JLG members sign a joint undertaking to the bank re-enforcing collective responsibility for repayment. To promote smooth working among the JLG members it is pertinent that they come from a similar socio-economic background. Also, every member in his free will and without any coercion should consent to join the group.

The farmers should be residents of the same village so that they know each other very closely and also have mutual trust to undertake the liability for the group. Members of the group should not have defaulted in loan repayment in any other financial institution in the past. The members should be carrying out farming for not less than one year inside the operational area of the bank branch. Members of same family cannot come together to form the JLG. Membership should be limited to only one person from one family.

**No. of Members**

Ideally a JLG group should have minimum of four and maximum of ten members for effective functioning. Small groups enable member-bonding to offer mutual guarantee. Large groups are normally found to be less successful in upholding the obligation of mutual guarantee.

**Assessment of JLGs for Bank Finance**

Bank finance to JLG happens through any of the following framework:

- **I.** Financing separate members in the Group (Model A) – In this model loan is provided to individual members of the group. However, all members have to jointly execute an undertaking for mutual guarantee obligation for the loan availed by individual members of the group. Assessment of credit by the bank would be done individually based on type of crop, area of cultivation and individual credibility but the repayment responsibility would lie on the entire group. All members should agree to the individual debt liability that will be created.

  Since loan is given individually the JLG has to prepare credit plan for individual members and aggregate them before submission to the bank branch. The individual members become eligible for the loan only after the bank confirms their credentials.

- **II.** Financing the Group (Model B) – In this model loan is provided to the group as single amount which is the aggregate of credit requirement of each of the members. The credit eligibility would be decided based on the available cultivable area and crop to be cultivated by each member of the JLG. In this model also all members have to jointly execute an undertaking towards joint liability for repayment of the loan.

**Purposes of Credit**

The finance to JLG addresses the need for working capital by the members for crop production, consumption, post- harvest processing and marketing.

**Loan Limit**

The maximum eligibility for crop loan is limited to Rs 50000 per individual under both the models.

**Security**

Lending to JLG is not against any collateral. The mutual guarantee offered by the members serves as social collateral. Since the scheme is beneficial to the farmers who do not have land collateral to offer to the bank in their individual capacity, lending under this scheme is considered as microfinance. It also falls in the category of direct agricultural advance under priority sector lending. Banks' lending under this scheme is eligible for hundred percent refinance from NABARD.

## 3.2. Three Tier Cooperative Structure for Credit Delivery

Cooperatives are the pillar of banking in rural areas. Till the end of sixties cooperatives formed the only vehicle for distributing rural credit. Later Commercial Bank was nationalized and a new category of bank called Regional Rural Banks was formed to supplement the rural outreach of cooperative banks. Cooperatives have a massive presence in rural areas which exceeds that of any other banking category and hence Government has always put in effort to strengthen them and make them sustainable.

The cooperative structure consists of the following three categories as shown in Figure 1:

1. Short term Credit Structure for financing short term credit requirements in rural areas
2. Long Term Credit Structure for financing the investment credit requirement in rural areas
3. Urban Cooperative Credit Structure for disbursing loan for consumption in urban areas

**Short Term Co-operative Credit Structure**

The rural co-operative credit structure for providing short term loans generally caters to farm production from preparing the land for sowing till marketing. They also provide term loan with maximum tenor of five years for agriculture investments like purchase of agricultural equipment, livestock etc. This structure comprises of three levels as shown in **Figure 3.2**

I. Primary Agricultural Credit Societies (PACS) at the Village level
II. District Central Cooperative Banks at the District level
III. State Cooperative bank at the State level

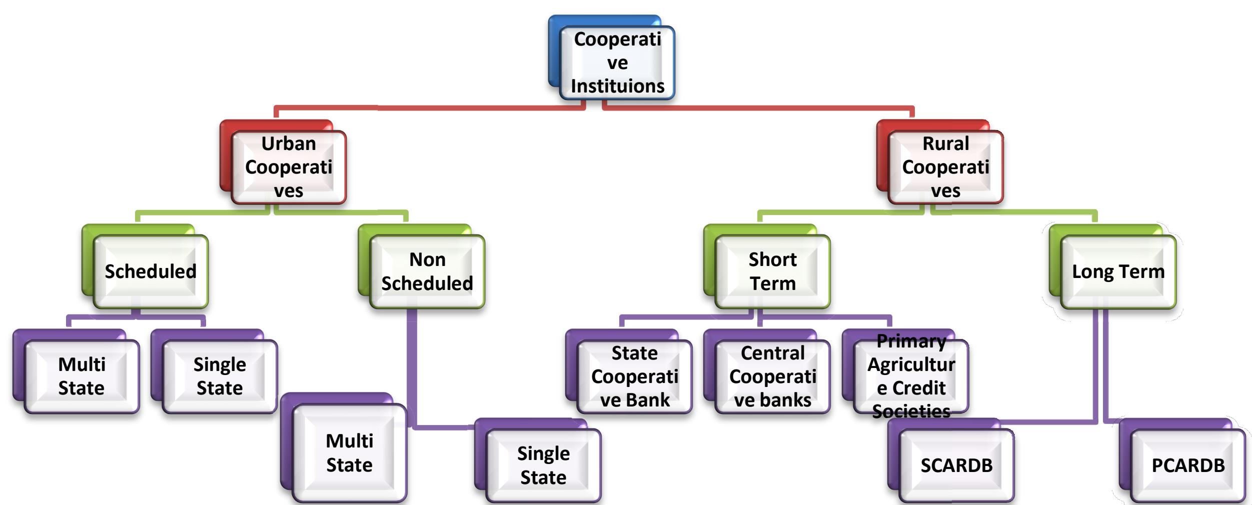



**Figure No.3.2:** Cooperative Credit Institutions in India

**Primary Agricultural Credit Societies**

At the bottom level in the cooperative hierarchy are the Primary Agricultural Credit Societies (PACS) which operate in the villages. The farmers of same village or nearby villages become member of PACS. The PACS were formed under the Cooperative Societies Act 1904, to curb the menace of the village money lenders who used to lend at usurious rates pushing the villagers into debt trap. There were 95238 PACS in the country as on 31st March 2018.

PACs have multipurpose role but at present the major activity is to disburse credit. The main functions of PACS are:

- **I.** To accept deposits and meet the short- and medium-term credit requirement of its members.
- **II.** To promote savings habit among rural masses.
- **III.** To undertake educative, advisory and welfare function for farmer's benefit.
- **IV.** To initiate efforts to recover the loan advanced
- **V.** To promote economic interests of its member
- **VI.** To act as an agency for implementing development schemes of the Government

PACs receive funds from share capital contribution by members, reserves, money deposits from fellow Members and Public, and borrowings from District Central Cooperative Bank, the higher-level cooperative structure. Reserve fund are the funds which is set aside from the earnings of the Society to meet the future contingencies. PACS have various sources of finance for extending credit like own capital, member deposits and refinance claim from the Central Cooperative Bank and Apex Cooperative Bank. The performance figure of PACS for 2016-17 and 2017-18 **(Table 3.1)** reveals that while the amount of deposits and borrowings have risen by 3.2% and 2.8% respectively the short-term lending has reduced by 1.1%.

**Table 3.1:** Performance of Primary Agricultural Credit Societies

| | Performance of Primary Agricultural Credit Societies | | | (Amount in Crores) | |
|---|---|---|---|---|---|
| | | As at End March | | Variation % | |
| | | 2,017 | 2018 | 2016-17 | 2017-18 |
| | 1 | 2 | 3 | 4 | 5 |
| A. | **Liabilities** | | | | |
| 1 | Total Resources (2+3+4) | 2,73,697 | 2,78,907 | 14.9 | 1.9 |
| 2 | Owned Funds (a+ b) | 32,982 | 30,942 | 34.9 | -6.2 |
| a. | Paid-up Capital | 14,122 | 14,142 | 15 | 0.1 |
| | of which Government Contribution | 829 | 807 | 3.9 | -2.7 |
| b. | Total Reserves | 18,860 | 16,800 | 55.1 | -10.9 |
| 3 | Deposits | 1,15,884 | 1,19,632 | 14.7 | 3.2 |
| | Borrowings | 1,24,831 | 1,28,333 | 10.8 | 2.8 |
| 5 | Working Capital | 2,39,967 | 2,43,563 | 19.2 | 1.5 |
| B. | **Assets** | | | | |
| 1 | Total Loan Outstanding (a+ b) | 1,70,459 | 1,69,629 | 7.6 | -0.5 |
| a) | Short-Term | 1,22,194 | 1,20,823 | 4.4 | -1.1 |
| b) | Medium-Term | 48,265 | 48,806 | 16.5 | 1.1 |

**Source:** NAFSCOB

**Weaknesses of PACS**

The undermentioned are the weaknesses of PACS:

I. Low membership and low capital base make them unviable
II. Financial assistance provided by PACs is inadequate so the villagers are still dependent on moneylenders. There is rationing of credit.
III. Personal and vested interest of the members affects the operational efficiency.
IV. Supervisory mechanism over members and borrowers is very lax.
V. There is delay in sanction and disbursement of loans so farmers don't get financial help in time.
VI. Lack of professional management coupled with political interference adversely effects the lending operations and loan recovery.
VII. Loans are sanctioned to undesirable elements rather than the needy farmers due to partisan behavior of management bodies

**Central Cooperative Banks**

Central Cooperative Banks fulfill the requirement of funds and management support to PACs. The Central Cooperative banks were established under the Cooperative Societies Act 1912. The Central Cooperative Bank is formed by a federation of PACS in a particular area for collective banking activities.

Each district has a Central Cooperative Bank which supports all the PACs in the district. The DCCB mobilizes funds by collecting deposits from urban areas and utilizing them in rural areas. The PACS are member-shareholder of the DCCB. There is only one DCCB in a particular district. There were 370 District Central Banks in March 2017 which reduced to 363 at the end of March 2018. Performance analysis of DCCBs during 2016-17 and 2017-18 **(Figure 3.3)** reveals that while there was moderate growth in deposits by 5% the loans and advances rose by 10%. There was decline in borrowings during the same period. Non-Performing Assets were very high at 10.5% of loan outstanding.

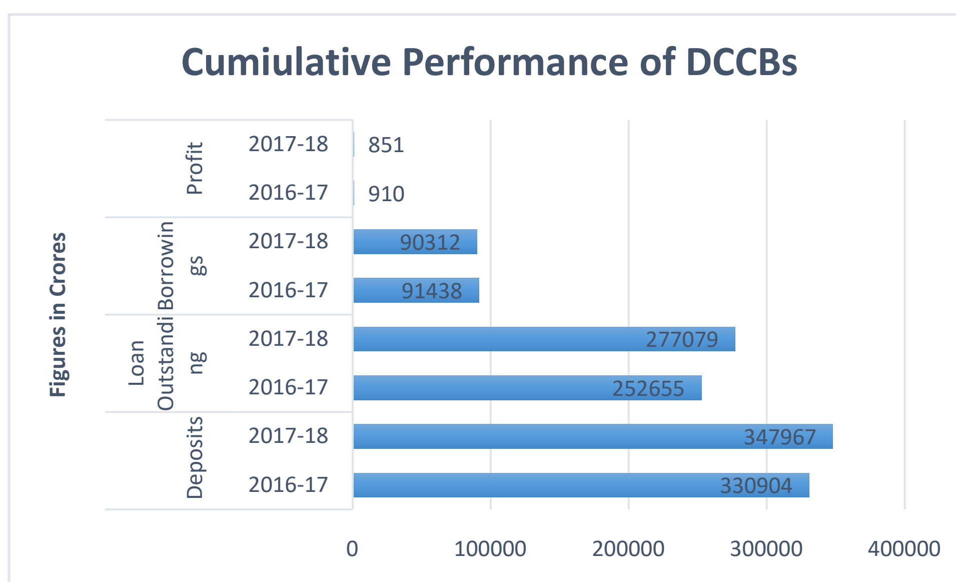



**Figure 3.3:** Progress Under eNAM | Source: Annual Report, NABARD 2019

The responsibility of DCCB is to provide short- and medium-term monetary assistance to the PACS. Loan is provided to each society up to a limited fixed amount depending on the repayment capacity of the society. Loan granted to PACS is secured against land, house, bond, fixed deposit, gold and jewelry. Loans provided to PACS are 3-4 percent higher than the rate at which the DCCB borrows funds. The margin serves as income for the DCCB to meet its administrative costs.

**The sources of funds for DCCB consist of:**

- **I.** Share Capital contribution by PACS
- **II.** Reserve Funds
- **III.** Member and Non-Member Deposits
- **IV.** Borrowings from apex bank/State Cooperative Bank

General Body of DCCB consists of representatives of all the member cooperatives. General body elects the board members. There are nominated members also.

Board elects the Chairman and Vice Chairman of DCCB. The administrative functions are carried out by a full time Chief Executive Officer appointed by the board.

**Issues Effecting the Functioning of DCCBs**

1. Delay in loan sanctions
2. Mounting Over dues resulting from impaired loans
3. Flawed Investment policy
4. Lack of quality assessment before sanctioning loans leading to mounting over dues.
5. Lack of professionalism in management
6. Most of the DCCBs have eroded their capital base due to mounting overdues.

**State Cooperative Bank (StCB)**

The Cooperative system has a federal character. Before Independence many District Central Cooperative Banks had surplus funds but they were not in a position to find avenues to utilize them. At the same time there were few others who were starving to fulfill their daily needs. So, there was need for an Apex Cooperative Bank to co-ordinate the activities and functions of the DCCBs. At present Apex Cooperative Banks function at the state levels and co-ordinate with the DCCBs.

The State Government and the DCCBs contribute to the Share Capital of the State Cooperative Banks. The StCBs extend financial support to DCCBs, who in turn provides assistance to Primary Cooperative Societies. Primary Co-operatives provide direct support to the individual members StCBs lend to DCCBs through various lending instruments like loans, cash credit facility and overdraft facility to the members. At the end of March 2018 there were 33 StCBs in the country. Their performance is given in **Figure 3.4**. Deposit mobilization has remained stagnant while loan outstanding has increased by 4% and borrowings have reduced by 11%

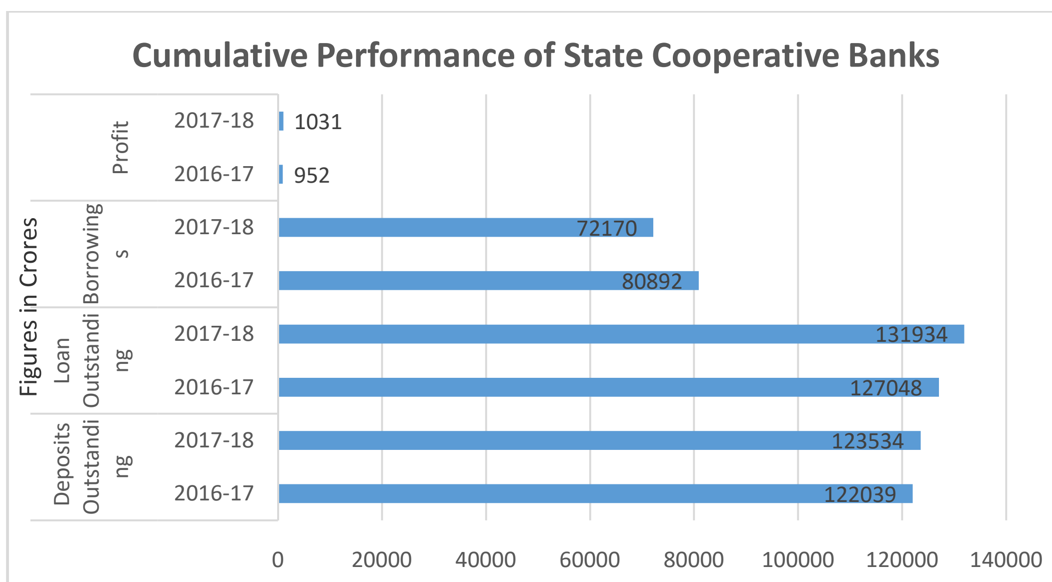



**Figure 3.4:** Cumulative Performance of State Cooperative Banks | **Source:** Annual Report 2018-19, NABARD

**Short-Comings of the STCB**

- The STCBs generally boosts recovery through book adjustments without actually recovering the money
- There are political interferences mostly on banking activities
- Deposit collection from Individuals is very low
- Defective Credit appraisal procedures, poor monitoring and supervision leads to increase in recoveries
- Most of the STCBs are financially in bad shape due to capital erosion

Due to the weaknesses discussed in preceding paragraphs, there has been an overall decline in the contribution of cooperative banks in the distribution of rural credit. They have lost their share to other two agencies, the Commercial Banks and the Regional Rural Banks. In the last five years the share of co-operatives in the total agricultural credit flow has reduced from 16 percent to 12 percent as shown in **Figure 3.5**

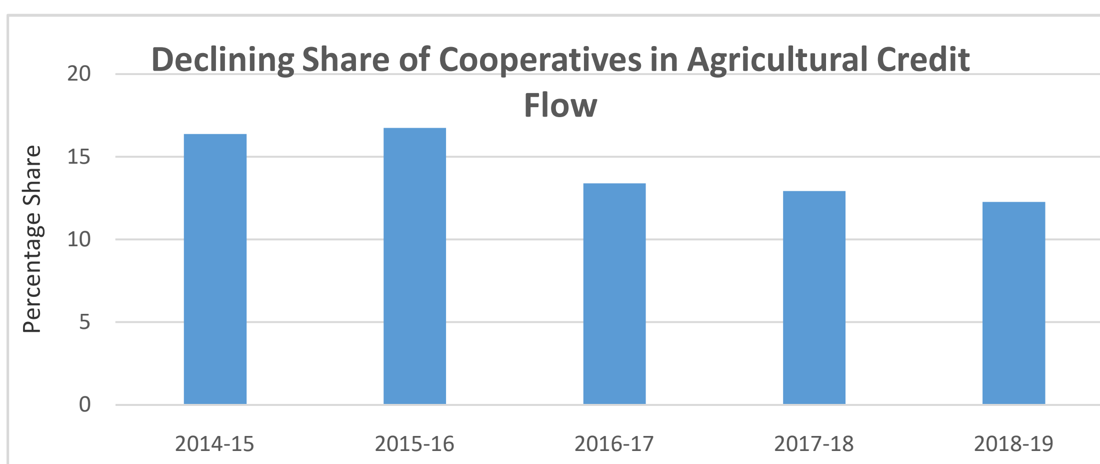



**Figure 3.5:** Declining Share of Cooperatives in Agricultural Credit Flow | **Source:** NABARD Annual Report 2018-19

The weaknesses in the cooperative bank structure have to be addressed on priority so that they become the leaders in Agricultural Credit delivery, similar to the Commercial banks.

**Long Term Rural Credit Structure**

The long-term lending institutional credit framework is either single layer or double layer varying from state to state. The Apex structure is known as State Cooperative Agriculture and Rural Development Bank (SCARDB) below which there are Primary Cooperative Agriculture and Rural Development Bank (PCARDB) at the District Level. In the single layer structure, the SCARDB channels rural credit through its own branches since PCARDBs are not there. There are 13 SCARDB and 601 PCARDB in the country as on March 2018.

**Urban Cooperative Banks**

These banks are found in non-rural locations and cater to the consumption needs of the area. They are of two types - Scheduled and Non-Scheduled. Scheduled banks are those whose names are incorporated in the Second Schedule of Reserve Bank of India Act, 1934. Non-Scheduled Banks have a reserve capital below 5 lakh rupees and unlike the scheduled commercial banks they cannot borrow from RBI for normal banking activities. Operation of some of the Urban Cooperative Banks may be restricted to only one state while others may operate in more than one state.

## 3.3. Kisan Credit Card

Kisan Credit Card scheme was introduced in 1998 as per RBI direction to the banks. The three agencies identified for implementing the scheme are the Commercial banks, Co-operative Banks and Regional Rural Banks. The aim for introducing the is to provide short term credit support to the farmer on time. Loan is provided through a single window with simple and flexible procedures. One of the methods of disbursing crop loans is through KCC by which the farmer can utilize the loan amount as per his requirement. The total figure for the number of Kisan Credit Cards circulated and cumulative sum outstanding is 1766 lakhs and Rs 686182 Crores respectively as on March 2018. **(Table 3.2)**

**Table 3.2:** Agency-wise - Cumulative Credit Cards Issued and Amount Outstanding

| Agency-wise - Cumulative Credit Cards Issued and Amount Outstanding as on 31 March 2018 | | | | | | | Amount in Crs & Nos. In Lakhs |
|---|---|---|---|---|---|---|---|
| Commercial Banks | | Cooperative Banks | | Regional Rural Banks | | Total | |
| Cumulative Card issued since Inception | Amount outstanding under operative KCCs | Cumulative Card issued since Inception | Amount outstanding under operative KCCs | Cumulative Card issued since Inception | Amount outstanding under operative KCCs | Cumulative Card issued since Inception | Amount outstanding under operative KCCs |
| 926.99 | 391134.08 | 550.21 | 126608.14 | 289.49 | 168440.72 | 1766.68 | 686182.94 |

Source: Agricultural Statistics at a Glance (2018)

Loan is provided through Kisan Credit Card to help farmers in meeting the:

I. requirement of working capital for crop cultivation
II. expenses for Post- Harvest activities
III. expenses for Marketing the produce

IV. household Consumption expenses
V. expenses towards farm asset maintenance and allied agricultural activities
VI. expenses on farm Investment e.g., procurement of pump sets, sprayers etc.

In the Union Budget of 2018-19 the kisan credit card facility has been extended from agriculture to Animal Husbandry and fisheries with facility for interest subvention for credit support up to Rs 200000.

**Eligibility for Short Term Credit**

The crop loan through KCC can be provided to:

I. All farmers who have ownership title to the land
II. Farmers who are Tenant, Leasehold farmers
III. Farmer groups or Joint liability Groups which also includes non-owner cultivators

**Documentation Requirement and Processing Charges**

The following documents are normally required to be submitted along with the application for issuing KCC:

1. Submission of Identity Proof**:** Any of **t**he following documents are accepted as identity proof- Voter ID or Driving Licence or PAN / Aadhaar / Passport / Photo Identity provided by Government bodies etc.
2. Submission of proof of residence: The following are accepted as proof for residential address confirmation – Latest telephone bill / Latest electricity bill / Recent property tax receipt (should not be older than 2 months) / Voter's ID card / Aaadhaar Card / Passport / Certificate issued by Govt. Authority / Local Panchayat /Municipality etc.
3. Latest photo of applicant which is not older than 6 months.
4. Land Records details.

There is no fee applicable for loan processing, inspection or for any other service under KCC scheme up to loan limit of up to Rs. 3 lakhs. The loan is provided at subsidized annual interest of 7 percent and there is further provision for concessional interest rate of 4% per annum for timely repayment of the short-term crop loans up to Rs. 3.00 lakh

**Fixing Short Term Loan KCC Limit for Farmers (except marginal farmers)**

*a) Those raising single crop in a year*

Loan limit sanctioned under KCC scheme consists of two parts; first part is the short term loan or crop loan payable in one year while the second part is the term loan payable in five years period. The short term loan provides working capital to the farmers while the term loan provides the capital for agri-investment. The credit to be provided for production in the first year is calculated as follows:

I. Loan for Production =Scale of Finance X extent of area cultivated
II. 10 percent additional limit for post- harvest expenses & consumption expense
III. 20 percent additional limit to meet the expenses incurred on repairing and maintaining farm assets.
IV. Expense towards insuring crop and farm assets is also covered
V. Total Crop Loan Limit for first year = I +II +III+IV

In the second year, First year limit for crop cultivation plus 10 percent limit would be added towards cost escalation.

In every subsequent year till the maximum tenor of the card, 10 percent limit would be added over the previous year. Estimated Term loan requirement for any year during the tenure of the card is added to loan limit for the year. **Refer Illustration 1 for calculation of credit limits**.

The loan amount is based on loan per unit area (scale of finance) which is fixed for a particular crop by the Technical committee formed at District Level.

*b) Those cultivating two or more than one crop in a year*

The loan ceiling is calculated based on the proposed annual cropping pattern during the first year. Additional ten percent is provided every year for next four years towards cost escalation. The bank considers the same cropping pattern under the assumption that the farmer will not change it for remaining four years. However in case there is change in cropping pattern in subsequent years then the limit has to be reworked. The limit of long term loan is calculated on the basis of investment planned by the farmer during the five year period and evaluation of repayment capacity of the farmer by the bank.

The limit of short term credit arrived for each year till the fifth year and the estimated term loan requirement, together forms the maximum permissible limit. Within the maximum permissible limit there are annual sub-limits which the farmer can withdraw every year. **Refer Illustration 1 for calculation of credit limits.**

**Illustration1: Calculation of Maximum. Permissible Limit of KCC**

**Case A for Small Farmer who raises Multiple Crops in a year**

**1. Assumptions:**

A. Let's assume Land holding is 2 acres

B. Cropping Pattern is assumed as: Paddy in 1 acre (Let us say that, Scale of finance including crop insurance per acre is Rs.12000); Sugarcane in 1 acre after harvesting paddy (Let us say, Scale of finance including crop insurance per Acre is Rs.23, 000)

C. Investment/Allied Activities:

Start a dairy unit with 1+1 Dairy animal in 1st Year (Let's say unit cost per animal is Rs.25, 000)

Replace the existing Pump set in 3rd year (Unit Cost of new pump-set is Rs.25, 000)

**2. (i) Crop loan Component**

The total Cost of cultivation of 1 acre of Paddy and 1acre of Sugarcane based on scale of Finance (12,000+23,000) = Rs.35, 000

10% extra amount is added towards post- harvest/household expense/consumption= Rs. 3,500

20% extra amount is added towards overall maintenance of the farm = Rs. 7000

**Therefore, total limit for Crop Loan during 1st year would be 33000+3500+7000= Rs. 43500**

**Loan Limit for 2nd year**

For 2nd Year, the limit of first year is increased by 10% to take care of cost escalation/increase in scale of finance (10% of 43500 i.e., 4350) = Rs. 4,350

**Therefore, Total limit of Crop Loan during 2nd year would be = 43500 +4350= Rs. 47850**

**Loan Limit for 3rd year**

For 3rd Year, the limit of second year is increased by 10% to take care of cost escalation/increase in scale of finance (10% of 47850 i.e., 4,785): Rs. 4,785

**Therefore, total Crop Loan limit during 3rd year would be = 47850 +4785= Rs. 52635**

**Loan Limit for 4th year**
For 4th Year, the limit of third year is increased by 10% to take care of cost escalation/increase in scale of finance (10% of 52635 i.e.,5263 approx) = Rs. 5263

**Therefore, total Crop Loan limit during 4th year would be= 52635 +5263= Rs. 57898**

**Loan Limit for 5th year**
For 5th Year, the limit of fourth year is increased by 10% to take care of cost escalation/increase in scale of finance (10% of 57898 i.e., say 5789.8 say 5790) = Rs. 5790

Therefore, total limit of crop loan limit during 5$^{th}$ year would be = 57898 +5790= Rs. 63688
Say: Rs.63690…. (A)
(ii) Term loan component:
Expense for 1+1 dairy unit during 1st Year= Rs.50000
Expenses towards Replacement of Pump set in third year: Rs. 25,000
Therefore, Total term loan amount = Rs.75000……. (B)
**Maximum Permissible Kisan Credit Card Limit= (A) + (B): Rs.1,38690**

**Case B: For other Farmer (excluding small farmers) who raise Multiple Crops in a year**
1. Assumptions:
Let's assume Land Holding is 10 acres
Cropping Pattern is assumed as: Paddy in 5 acres (Let us say that, Scale of finance including crop insurance per acre is Rs.12000)
Groundnut in 5 acres after harvest of paddy (Let us say that, Scale of finance including crop insurance per acre is Rs.11000)
Sugarcane in remaining 5 acres (Let us say that, Scale of finance including crop insurance per acre is Rs.23000)
Investment/Allied Activities:
(i) Start a dairy unit with 2+2 Dairy Animal in 1st Year (Let's say cost per animal is Rs. 25000**)**
(ii) Purchase of Tractor in 1st Year (Unit Cost: Rs.500000)

**2. (i) Crop loan Component**
The total Cost of cultivation of 5 acres of Paddy, 5 Acres of Groundnut and 5 acres of Sugarcane based on scale of finance (Rs.60000 + 55000+115000) =230000 --------------------A
10% additional amount is added towards post- harvest/household expense/consumption: Rs. 23000 ------B
20% additional amount is added towards farm maintenance: Rs. 46,000 -----------------------C
Therefore, the total Crop Loan limit for 1st year would be: A+ B+C = Rs.299000

**Loan Limit for 2nd year**
For second year the loan amount is increased by 10% to take care of cost escalation/increase in scale of finance (10% of 299000 i.e., 29900) = Rs.29900
Therefore, the total limit of Crop Loan for 2nd year would be = 299000+ 29900=Rs.328900

**Loan Limit for 3rd year**
For third year the loan amount is increased by 10% to take care of the cost escalation/increase in scale of finance (10% of 328900 say, 32890) = Rs.32890
Therefore, the total limit of Crop Loan limit for 3rd year would be =328900+32890=Rs.361790

**Loan Limit for 4th year**
For fourth year the loan amount is increased by 10% to take care of the cost escalation/increase in scale of finance (10% of 361790 say, 36180)= Rs.36180
Therefore, the total limit of Crop Loan limit for 4th year would be =361790+36180=Rs.397970

**Loan Limit for 5th year**
For fifth year the loan amount is increase by 10% to take care of the cost escalation/increase in scale of finance (10% of 397970 i.e., 39797 say 39800) = Rs.39800
Therefor the total Crop Loan limit for 5th year would be =397970+39800=Rs.437770
Say Rs.437770 … …………………. (A)

**2(ii) Term loan components:**
Expense for establishing 2+2 Dairy Unit during 1st year = Rs. 100000
Expenses towards purchase of Tractor during first year = Rs .500000
**Therefore the total term loan amount: Rs.600000………… (B)**
**Maximum Permissible Limit /Kisan Credit Card Limit (A) + (B) = Rs.1037770 approximately**
**Note:**
At the end of every year the drawing limit will be reduced based on repayment schedule of the term loan(s) availed and further withdrawals will be allowed only up to the drawing limit.

**Fixation of Sub-Limits of the Kisan Credit Card within the Maximum Limit**

As seen from the Illustrations 1 & 2 there are two parts of the maximum permissible card limit of KCC. One is the short-term cash credit limit (crop loan portion) and the other is the term loan limit.

This is done for convenience in maintaining the accounting transaction records because:

I. The interest on crop loan and term loans varies.
II. Benefit from Subvention and Prompt repayment is applicable to Crop loan/Short term loan
III. Repayment schedule varies for crop loan and term loan.

In case the scale of finance is revised and the eligibility amount after revision exceeds the notional annual hike of 10 percent towards cost escalation then the limit for KCC needs to be revised.

Instalment related to term loans can be withdrawn based on the investment plan submitted to the bank and the mutually agreed repayment schedule drawn on the basis of the economic life of the asset. However, it is warranted that the total liability should be within the drawing limit of the concerned year.

### Fixation of Loan Limits for Marginal Farmers

A flexible limit varying between Rs 10000 to Rs 50000 is applicable for marginal farmers based on their land holdings and crop cultivated. Additionally, it includes the expenses for post- harvest processes, other farm expenses and consumption need. Small term loan investment is also added for backyard poultry or dairy cattle or farm equipment without referring to the land value. The composite KCC limit which includes crop loan and term loan is fixed for a period of five years**. The calculation of KCC limit is illustrated in Illustration 2**

**Illustration 2: Eligibility Calculation of Maxm. Permissible Limit of KCC for Marginal Farmer raising Single Crop in a year**

**1. Assumptions:**

a. Let's assume Land holding is 1 acre

b. Crops Pattern is assumed as: Paddy in 1 acre (Let us say that Scale of finance including crop insurance per acre is Rs.12000)

c. It is also presumed that there is no change in Cropping Pattern for 5 years

d. Investment activities to be financed includes One Non-Descript Milch Animal (Let us say unit cost of milch animal is Rs: 20,000)

**2. Assessment of Card Limit:**

**(i) Crop loan Component**

Total Cost of cultivation of Paddy on 1 acre land area = Rs.12,000

10% additional amount is added towards post-harvest/household expense/consumption= Rs. 1,200

20% additional amount is added towards expense towards farm maintenance : Rs. 2,400

Therefore the Total Crop Loan limit for 1st year would be = 12000+1200+2400= Rs.15600……………………………………………………….A

**(ii) Term Loan Component**

The total cost of purchasing one milch animal = Rs.20000…… ………………………B

The Combined KCC Limit for first year would be = A + B = Rs.35600

**2nd Year :**

**Crop loan component:**

10% additional amount is added towards cost escalation/ increase in scale of finance =[10% of 15600= 1560]

Therefore the total crop loan limit for 2$^{nd}$ year would be Rs. 15600+1560= 17160…………C

The combined KCC Limit for second year would be = C+B= ( 17160+20000) : Rs.37160

**3rd Year** :

**Crop loan component:**

10% additional amount is added towards cost escalation/increase in scale of finance [10% of 17160= 1716]

Therefore the total crop loan limit for 3$^{rd}$ year would be Rs. 17160+1716= 1 8876 say 18880….D

**The combined KCC Limit for third year would be : B+D= ( 18880+20,000) : Rs.38880**

**4th Year :**

**Crop loan component:**

10% additional amount is added towards cost escalation/increase in scale of finance [10% of 18880= 1888]

Therefore the total crop loan limit for 4$^{th}$ Year would be Rs 18880+1888 =20768 say 20770…………E

**The combined KCC Limit for fourth year would be : B+E= ( 20770+20,000)= Rs.40770**

**5th Year:**
**Crop loan component:**
10% additional amount is added towards cost escalation/ increase in scale of finance [10% of 20770= 2077 say 2080]
Therefore the total crop limit for 5th Year would be Rs 20770+2080 =22580…………F
**The combined KCC Limit for fifth year would be : B+F= ( 22580+20,000) : Rs.42580 Say Rs.43000**

**Disbursement of Kisan Credit Card Loan**

The crop loan portion of the total limit is treated as rotating cash credit so there is no limitation on the frequency of withdrawals and deposits except that Debits balance in account should not exceed the prescribed limit. Out of the total annual drawable limit, the amount which is actually withdrawn has during the year has to be repaid within a period of 12 months

The drawing limit can be utilized by using the undermentioned modes of withdrawal:

I. By visiting the branch
II. By use of ATM/Debit Cards
III. By utilizing the services of Business Correspondents and ultra –small branch outlets
IV. By use of the cheque-book facility
V. By use of PoS device available with input dealers
VI. Operation through PoS device available with Companies like Sugar Mills /Contract Farming Companies especially in case where there is a tie up for recovery of advances

The long-term loan may be withdrawn by using the above-mentioned sources as per the instalment fixed. As on March 2019 maximum number of credit card were issued by Scheduled Commercial Banks followed by Cooperative Banks and then Regional Rural Banks. However, in terms of amount outstanding the cooperative banks lagged behind the other two agencies namely, SCBs and RRBs **(Figure 3.6).**

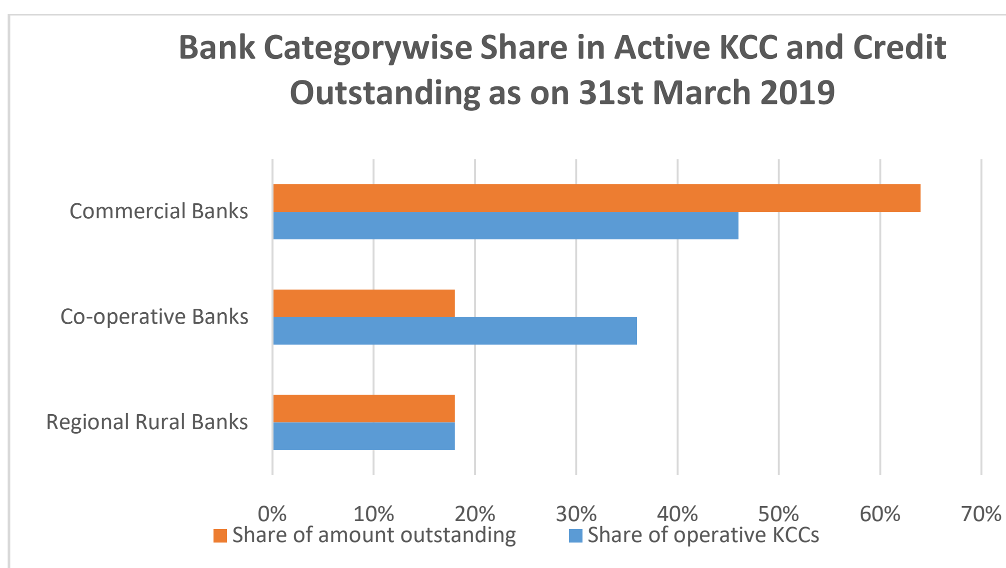



**Figure 3.6:** Percentage share of Institutional and Non-institutional Agencies in Outstanding Rural Credit | **Source:** Report of Internal Working Group to Review Agricultural Credit-2019

**Applicable Rate of Interest**

The interest rate is decentralized. It is linked to base rate and the margin is decided by the respective banks.

**Repayment Period**

In case of short-term loan, all withdrawal from the account should be repaid within 12 months.

The term loan part of the KCC limit needs to be paid within 5 years depending on investment type. Longer tenor may also be allowed as per the discretion of the banks.

**Security**

The crop loan eligibility is calculated on the basis of Type of crop and area of cultivation so it is concluded that the loan would be repaid by selling the crop. Hence it can be construed that the security of the loan is based on hypothecation of crops up to the limit sanctioned in the card. If there is assurance of loan recovery through contract with potential buyers, as in case of contract farming, banks can consider sanctioning a card limit of Rs 300000 against hypothecation of crop without urging on collateral security.

So, for all loan limit more than Rs 160000 where there is no deal for recovery, collateral security may be taken. In case there is tie up for recovery collateral should be insisted for loans above Rs 3 lacs. States where land records are accessible online and it is possible to create charge the same should be done while sanctioning the loan.

**Interest Subvention**

Interest Subvention Scheme is applicable on crop loans up to Rs.3 lakh sanctioned for one-year tenure. The loan is provided at discounted annual rate of 7% i.e., at 2% discount. In case of timely repayment there is further reduction in rate to 4% per annum.

**Classification of Loan as Non-Performing Asset under KCC**

If the balance outstanding in KCC account is equal to or less than the drawing limit at any point of time in preceding year it is considered as a standard account. Short term loan sanctioned on the KCC should be treated as cash credit account. It will become an irregular account only if the balance outstanding exceeds the drawing limit and any of the drawings remains unpaid for a period exceeding 12 months.

## 3.4. Short Term and Long-Term Needs of Indian Agriculture

Agriculture is considered an important area of Indian economy because of its ability to generate employment and provide food security. India cannot develop without developing the rural areas where 68 percent of the population resides. Credit for agriculture has played a crucial role in the development of farm sector and adoption of updated technology for farm processes. However, credit alone cannot ensure increase in productivity and income to farmers, as its effectiveness lies on other assisting elements like timely supply of inputs at reasonable price, updated knowledge for application of inputs, remunerative markets for the products etc.

The needs for Agriculture can be classified as:

I. Short Term Needs
II. Medium- and Long-Term Needs

Short-term needs are those related to the inputs required for cultivation of a crop. It includes various factors other than credit, like access to -seeds of high quality, fertilizers, pesticides, feeds or fodder for livestock, avenues for marketing of agricultural produce at best price, timely payment of wages of hired labor etc. Some of these inputs are available in cash like labour wages while for other inputs, payment can pay in kind also. Medium- and long-term needs pertains to the investment needs like agro-machinery, digging bore-wells etc.

### Short Term Needs

### Seeds

Seeds are an essential input for agriculture. Quality seeds are estimated to enhance the productivity of other input between 20- 25%. Seeds act, 1966 controls the production, quality aspects, and marketing of seeds. The act lays down the process of seed testing, certification and labelling of seeds for sale. The license for export and import of seeds is regulated by the Seeds Control Order, 1983.

Seeds that are commonly sown by the farmer are classified into three groups:

1. Seeds saved by farmers, constitute more than 65% of the total seeds consumed in the country. These are the seeds saved by the farmer from a crop grown on his own landholding for the purpose re-sowing
2. Commercially produced seeds which are certified, and
3. Hybrid seeds and genetically modified.

Seeds can also be classified based on its genetic purity:

I. Breeder seed means that the seed or the natural propagating material which is produced directly under the supervision and guidance of the plant breeding scientist or plant breeding institution. Breeder seed is multiplied for production of foundation seed. The breeder seed is labelled with golden yellow tag. It has 100 percent genetic purity.

II. Foundation seed is the offspring of Breeder seed. It is produced by licensed seed producing agencies like National Seed Corporation, State Seed Corporation etc. under control and guidance of seed certification authority in such a way that its quality adheres to prescribed seed standards. Foundation seed is identified by white tag.

III. Certified seed are the offspring of foundation seed and it is manufactured and supplied by registered seed growers either individual or companies under procedure and specification defined by seed certification agency. The seed which seed companies sell in the market is certified seed. Certified seed carries a green label. **(Figure 7)**

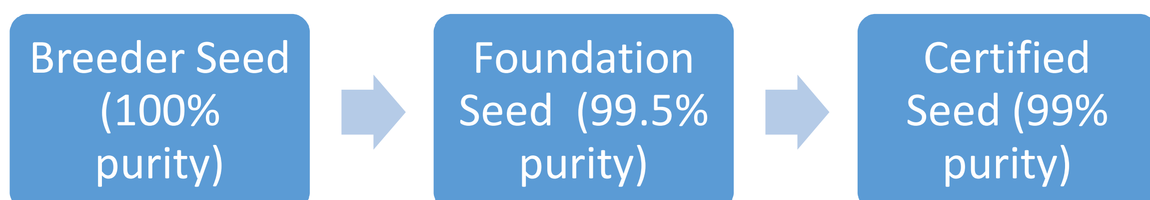



**Figure 3.7** Type of Seeds Based on Genetic Purity | Source: Designed by Author

Apex Agencies like The Central Seed Committee (CSC) and Central Seed Certification Board (CSTCB) were formed to regulate quality of certified seeds produced in the country. State, Agriculture Universities, Public Sector and Private Sector companies is involved in providing quality seeds. The Private and Public sector account for 30-35% of seed production and distribution in the country while rest is attributed to the unorganized sector including farm saved seeds.

Strict guidelines are prescribed for production, storage and maintenance of seed quality. These include various processes like seed certification, seed testing, seed labeling and implementation of seed law. States have their own Seed Certification agencies for quality assurance. They are 25 in number at present. There are 124 seed testing laboratories in the country to carry out seed analysis and testing.

Hybrid seeds are in high demand because of their yield potential so efforts should be directed towards increasing their production and distribution and reducing the prices. The challenge for the farmer is to acquire high quality seeds at price which commensurate with the quality. Instances of spurious seeds being supplied in the market are common which drastically reduces the yield.

**Fertilizer**

Ministry of Chemicals and Fertilizer regulates the manufacture, sale and distribution of fertilizers under the Essential Commodities Act, 1955. The transaction, pricing, quality control, marketing and distribution of fertilizer is guided by Fertilizer (Control) Order (FCO), 1985 which was circulated under section 3 of Essential Commodities Act.

Nitrogen (N), Phosphate (P), and Potash (K) are the three major type of nutrients in fertilizers. While the price of urea (contains N nutrients) is decided by the government, the prices of fertilizers containing P and K nutrients are decided by market demand and supply. Urea is the most used among all fertilizers. Though the recommended use of NPK fertilizers as advised by agricultural scientists is in 4:2:1 ratio, the actual usage ratio in India is as high as 6.7:2.4:1.

The challenge being faced is that, an overuse of urea has led to disparity in the soil nutrients and loss of fertility, adversely impacting the soil potential. It is the effort of the Government to encourage the farmers towards balanced use of chemical fertilizers in combination with non-chemical fertilizer like Organic Fertilizers, Bio-fertilizers, green manures etc. to protect the soil health and to reduce the environment pollution caused by use of chemical fertilizer. The Government is promoting the production and import of Neem Coated Urea under the National Urea Policy-2015.It improves the soil health and reduces the use of plant protection chemicals and also increases the yield. It also curbs the diversion of use of subsidized urea for non-agricultural purpose.

To provide fertilizers to the farmers at affordable price, the producers are provided with subsidy by the central government based on actual sale by the retailers. Over the years the subsidy burden of the Government has increased **(Figure 3.8)**. Subsidy on fertilizer is the second largest subsidy after food subsidy and managing the subsidy expenses is a challenge for the Government. Subsidy also leads to diversion of use of urea for non- farm purposes which is a loss to the economy. The Neem Coated urea is expected to stem this diversion of usage.

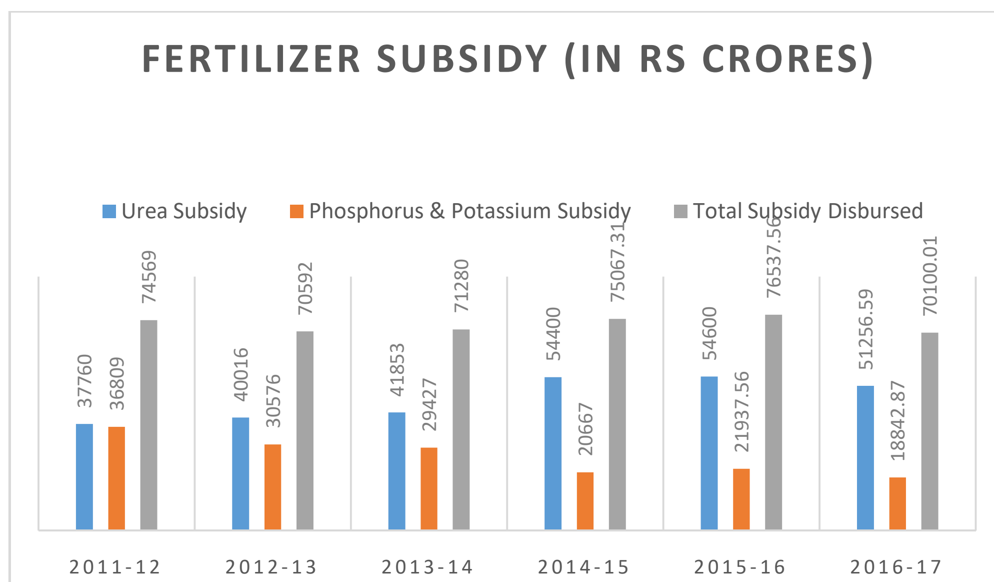



**Figure 3.8:** Regional Rural Banks-Outstanding Deposits & Credit | **Source:** State of Indian Agriculture 2017

At present the Government has introduced Direct Benefit Transfer (DBT) system to prevent leakages in payment of fertilizer subsidy. In this method total subsidy amount on different grades of fertilizers is directly transferred to the bank account of manufacturers and importers based on actual sales achieved by their retailer. The DBT is expected to curb the diversion of subsidized urea for non-agricultural use, thus reducing the subsidy outgo.

**Pest Control**

A major share of pesticide consumption in India is accounted for by Insecticides which are used on two counts: 1) Preventive treatments, which are applied as a precautionary measure anticipating pest infestation in future and 2) implementation treatments which are applied post infestation based on level of infection and expected crop damages. In early 1950s the use of pesticides in Indian agriculture was negligible. Only 100 tonnes of pesticides was being consumed at the beginning of the green revolution in mid-1960.

In subsequent years the use of pesticides increased leaps and bound as the new high yield varieties were more vulnerable to pests and insects' attack. Over the past few years, the demand for pesticides in the country has increased from 65468 metric tons in 2014-15 to 73244 metric tons in 2018-19 **(Figure 3.9)**.

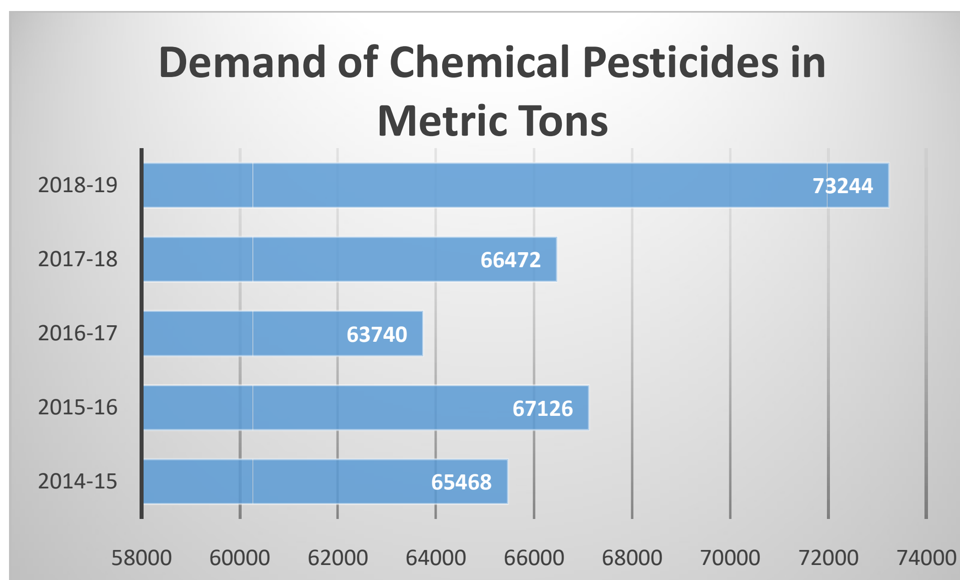



**Figure 3.9** Profitability of RRBs | **Source**: http://ppqs.gov.in/statistical-database

The major issues faced in respect to increasing usage of pesticides are:

1. Manufacture of substandard pesticides and release of harmful chemicals in the environment,
2. lack of awareness about pesticide use and precautions required,
3. deterioration in soil and environment health due to excessive use of pesticide

The rampant use of chemical pesticides without knowledge of the usage guidelines has resulted in a surge in harmful pesticide residue in food products in India. The Ministry of Chemicals and Fertilizers monitors the production of pesticides while their usage is regulated by the Agriculture Ministry.

The import, manufacture, sale, transportation, distribution and use of insecticides is regulated by The Insecticides Act, 1968. The act provides usage guidelines with the aim of preventing risk to humans or animal health, and prescriptions for related matters. The Central Insecticide Laboratory set up under the act is empowered to register insecticides and pesticides after testing its efficacy and safety parameters.

The Insecticide Act, 1968, needs to be reviewed so that the regulatory framework can be modified with changing times. A Pesticides Development and Regulation Authority needs to be formed to control the pesticide chain starting from manufacturing and import to sale of pesticides.

Other areas which need to be focused include evolving an integrated pest-management system, which refers to a combination of mechanical and biological alternatives for pest control and reduction of application of chemicals e.g. bio-pesticides. It is an ecofriendly approach, which focusses on using all available alternate methods of pest control such as cultural, mechanical and biological control to keep pests below economic thresholds level. It lays importance to use of pesticides derived from natural sources like plant, animal, bacteria etc. The use of chemical pesticides is advised only when pest level crosses the economic threshold level (ETL).Across the

country there are 35 Central Integrated Pest Management Centers (CIPMC) which implement activities related to IPM. Grow Safe Food campaign by CIPMC aims to sensitize the farmers regarding misuse of chemical pesticides causing harm to their health and overall health of the environment.

**Agricultural Market**

The agricultural production has increased over the years but the financial conditions of the farmer have not improved because of various reasons like:

1. Lack of fair and transparent markets near the farm gate
2. Availability of fair prices in the market
3. Lack of access to information regarding prices prevailing in other markets
4. Long chain of intermediaries who take share of every rupee profit earned
5. Fluctuation in market price of agricultural commodities
6. Lack of warehouses and cold stores

Agriculture sector requires markets with proper infrastructure near to the farm gate so that the farmers can save on the expenses they incur on transportation. There should be focussed attempts to link the farmers to the retail chains so that the produce can be picked up directly from the farm-gate at remunerative prices and farmers do not need to pay brokerage to the commission agents.

Modifying the present agriculture market system is necessary to curb the monopolistic practices prevalent in the present market, develop an integrated supply chain to reduce agricultural wastages, restrict the number of agriculture intermediaries, stabilise the fluctuation in prices of agricultural produce and to provide farmers an access to National and Global Markets. The farmer needs a market which is competitive, transparent, barrier free and provides real time prices to the farmers

The Government has shifted the policy paradigm from Food Security to Price Security to ensure prosperity of the farmers. Changes in the APMC Act and promoting contract farming are few ways by which Government wants to improve the marketing avenues. As a step in this direction, the Government has promulgated the Model APMC act in 2017. The model act provides full liberty to the farmers to market their products to the clients of their choice, through different marketing channel of their choice, to those who offer the most favourable price. The model act also provides incentives to woo the private players to invest in building post-harvest and marketing framework.

The parliament has recently passed the Farmers' Produce Trade and Commerce (Promotion and Facilitation) Bill, 2020 in the parliament by which the farmer would be able to sell their product outside the mandis to any customer of their choice who offers the most favourable price. It will unshackle the farmers who previously were legally bound to sell the produce only to the licensed traders in the designated market yards. These traders formed cartel to deny the most remunerative price to the farmer by price fixing.

Another bill called the Farmers (Empowerment & Protection) Agreement of Price Assurance and Farm Services Bill, 2020 is meant to provide legal shield to contract farming. The government hopes that by allowing private players, the farmers can potentially negotiate higher rates and become active participants in their economic prosperity. It will increase competition in the market. Since the contract will be executed in advance the farmer can plan the investment based on the income which is expected from the contract.

Both the pieces of new legislation seeks to allow private market forces into the largely government-regulated farm sector in India. Both the bills are awaiting the concurrence by the President of India. The Scheme of National Agriculture Market (e-NAM) was launched in April, 2016 so that the farmers have online access to different markets and buyers and discover the best price offered by them in a transparent manner. As on 31st March 2018, 585 designated wholesale markets (APMCs) are connected to e-NAM platform **(Table 3.3)**. Connection for another 415 markets is in process.

**Table No. 3.3: Progress Under eNAM**

| Serial No. | State | No. of Mandis |
|---|---|---|
| 1 | Andhra | 22 |
| 2 | Chandigarh | 01 |
| 3 | Chhattisgarh | 14 |
| 4 | Gujarat | 79 |
| 5 | Haryana | 54 |
| 6 | Himachal | 19 |
| 7 | Jharkhand | 19 |
| 8 | Madhya Pradesh | 58 |
| 9 | Maharashtra | 60 |
| 10 | Puducherry | 02 |
| 11 | Punjab | 19 |
| 12 | Rajasthan | 25 |
| 13 | Tamilnadu | 23 |
| 14 | Telangana | 47 |
| 15 | Uttar Pradesh | 100 |
| 16 | Uttarakhand | 16 |
| 17 | Odisha | 10 |
| 18 | West Bengal | 17 |
| | Total | 585 |

Source: https://enam.gov.in/web/mandis-online

Government is in the process of remodelling the already active 22,000 Gramin Haats into Gramin Agricultural Markets (GrAMs). These markets would serve as point for assembling and direct buying of farm products from the farmers. The GrAMs would also be connected to the Online Portal i.e., Electronic National Agricultural Market (e-NAM).

**Medium- and Long-Term Needs**

**Mechanization**

Mechanization is a very important factor for increasing agricultural productivity. It also helps in efficient utilization of ingredients used in crop production like seeds, fertilizers, chemicals & pesticides and natural resources like water, soil nutrients etc.

It also reduces manual efforts as well as the cost of production. It ensures protection and ease of work for the farm workers. It also gives quality output so that the farmer can think of value addition for better income. Also, the reduced rigour of farming, encourages the farmer to take more cycle of crops annually, making agriculture a profitable occupation. In summary it aids in transformation from subsistence to commercial farming.

86 percent of landholdings in India are less than 2 hectares makes individual ownership of farm equipment difficult and unviable. The abysmal usage of machinery usage in agriculture is evident from the data on ownership of agricultural equipment. **(Figure 3.10)**

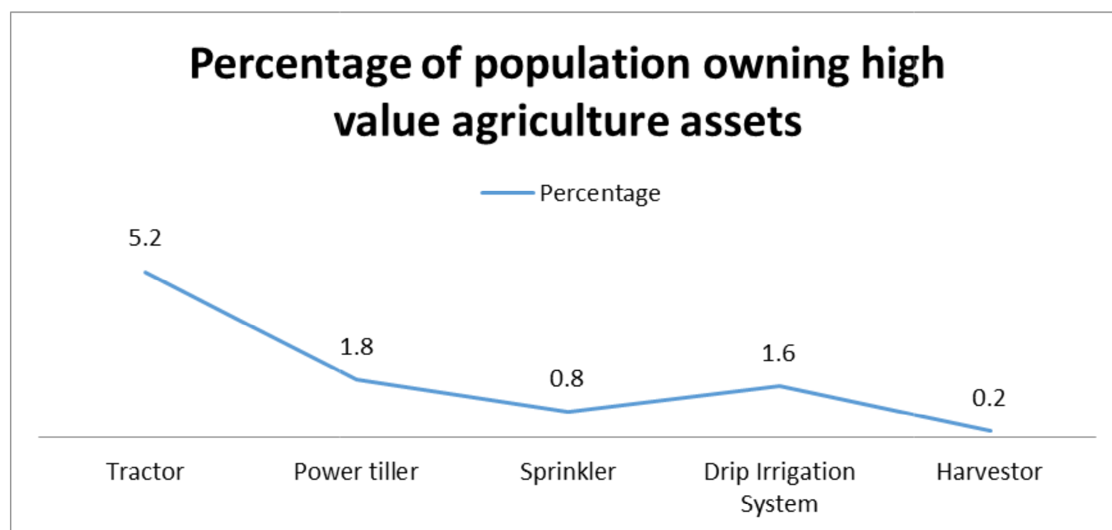



**Figure 3.10 Percentage of Population Owning High Value Agriculture Assets**

Source: State of Indian Agriculture

To overcome the problem of fragmented landholding which deters farmers from purchasing farm assets, Government has proposed to have Custom Hiring Centers for Agricultural Machineries. Such centres may be operated either by farmers' Group either in the form of Cooperative Societies, Self Help Groups etc. or by private/rural entrepreneur, on chargeable basis. This will give the farmers an access to farm machineries which will improve the farm productivity of Small & Marginal farmers will improve.

Farm equipments which are light, durable and low cost and also that are suitable for different crops and different regions should be provided to small and marginal farmers for better productivity.

Government has introduced Sub Mission on Agricultural Mechanization (SMAM) during 12th plan starting from April 2014. The aim of the mission is to:

I. Bring farm mechanization to the door steps of poor farmers and to those areas where penetration of farm mechanization is low;

II. Open 'Custom Hiring Centers' to counter the high cost of individual ownership resulting from small size of the land;
III. Build centers to showcase sophisticated high value farm machinery to increase awareness and accessibility
IV. Generate awareness among farmers and other stakeholders through exposure visits and training;
V. Provide financial support in the form of subsidy of 40-50% on the cost, for individual purchase of farm machinery.
VI. Financial assistance of 80 % to the farmer groups -Cooperative Societies, FPOs, Self-Help Groups and registered Farmers Societies for purchasing farm machinery

Though the process of mechanization is slow but still over the years the sale of tractors have increased which shows that mechanization is also catching up **(Figure 3.11)**

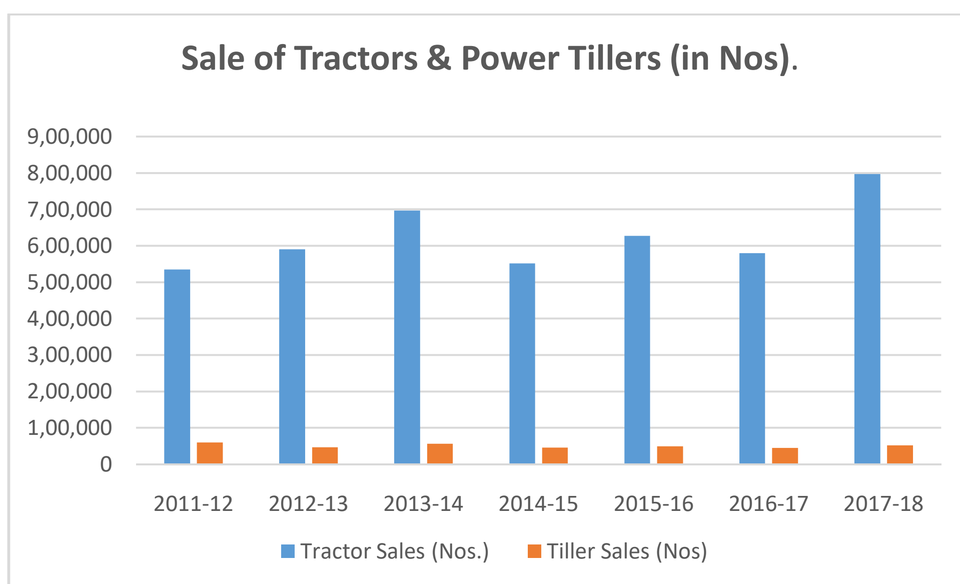



**Figure 3.11 Sale of Tractors and Power Tillers**

Source: State of Indian Agriculture

### 3.5. The Way Ahead- Self Sustenance

### Critical Evaluation of Role Played by Commercial Banks, Cooperatives and Regional Rural Banks in Economic Development

Till 1990, three agencies -Commercial Banks, Cooperative Banks and the Regional Rural banks, defined the overreach of the banking system to the secluded regions of the country. It was termed as credit delivery through multi- agency model. After independence, for first twenty years co-operatives were sole channel for meeting the loan requirement in remote areas. After nationalization of commercial banks in 1969 they amplified the effort of co-operative banks in credit distribution in village locations and curbed the influence of moneylenders who lent money at usurious rate of interest. Nationalization of banks also helped to materialize the social welfare schemes of the Government and extend their reach to remote areas of the country. In 1975 a new type of bank known as the Regional Rural bank was established to bring greater focus to rural locations while delivering credit. They were expected to blend the professionalism of Commercial Banks with the grass-root level familiarity of the cooperative banks. In 1982 the National Bank for

Agriculture and Rural Development was established for the purpose of supervision and refinance of agricultural loans provided by financial institutions.

In 1990 their focus shifted from credit delivery to sustainable banking with emphasis on cost control and profitability. Most of the banks were incurring losses due to mounting overdues, impaired collateral and laxity in recovery. Emphasis shifted from Branch Banking to banking through alliance with third party by harnessing the power of internet banking. Banking Correspondents were appointed as agents of bank in unbanked remote areas. Linkages were established between Bank and Self-Help Groups to reach the last mile. Specialized institutions, known as Microfinance Institutions (MFI) came into existence for providing small ticket loans to the poor.

**Commercial Banks**

By nationalizing the commercial banks in 1969, the Government's aim was to accelerate the credit supply to rural areas by increasing the physical reach of the banks in those areas, directed lending to the hitherto neglected but economically important sectors and fixing upper ceiling on lending rates.

Policies were framed with the aim to achieve the above objectives .Supportive Policies like 1:4 branch licensing policy were formulated to ensure that the new bank branches are not clustered in metropolitan and urban areas but they are also spread in unbanked rural locations. The policy mandated that a bank has to open four banking outlets in unbanked location to become eligible for starting a new bank outlet in locations which are already banked. The policy was in vogue till 1990.

With the view of ensuring credit flow to the neglected quarters, the policy of Priority Sector lending was put in place by which banks had to lend forty percent of their total credit to those sectors which were previously starved for credit. Then there was the Lead Bank policy, by which one of the Banks which had a prominent presence in the district was designated as the lead bank to dovetail the credit distribution effort of all banks in the district. It also had a stimulating effect on the credit outreach. The lead bank had two responsibilities: (a) To ensure that branches are opened in prominent areas of the district which is unbanked; (b) To channelize maximum credit flow towards development in the district.

As a result of these policies, there was quantum jump in the total number of bank branches starting at 8262 in 1969 to 60000 in 1991 **(Figure 3.12)**. Among these the maximum growth was in the number of branches in semi-urban and rural areas which rose from 5175 to 46550, implying that much of the expansion happened in the hitherto neglected areas. Figure 11 depicts the growth in number of rural and semi urban branches. The population served per branch reduced by nearly 78 percent, from 64000 in 1969 to 14000 in 1991. The per capita credit jumped from Rs 68 in 1969 to Rs 1434 in 1991 and Rs 4555 in 2000. Similarly, per capita deposit jumped from Rs 88 in 1969 to Rs 2368 to Rs 8542 in the year 2000 **(Figure 3.13)**

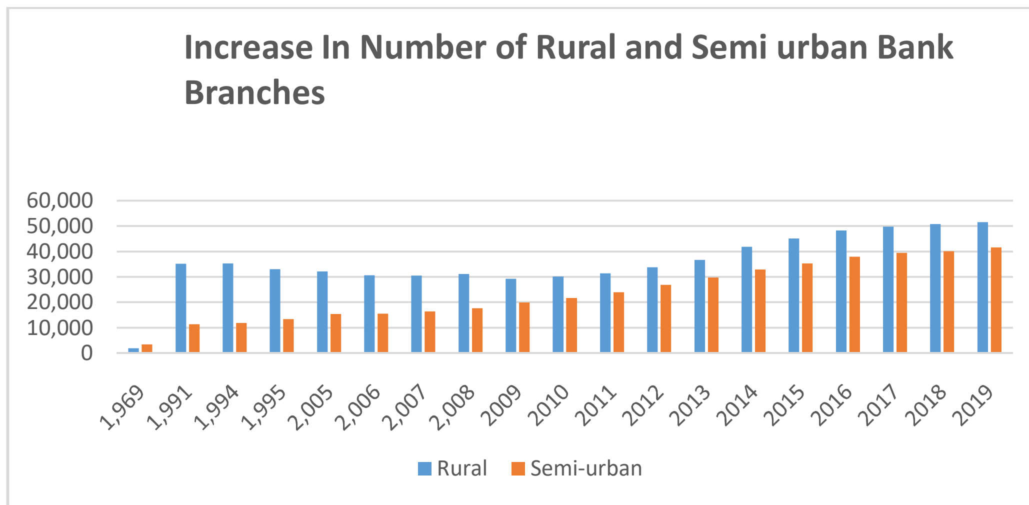



**Figure 3.12** | **Source:** Handbook of Statistics on Indian Economy 2018-19

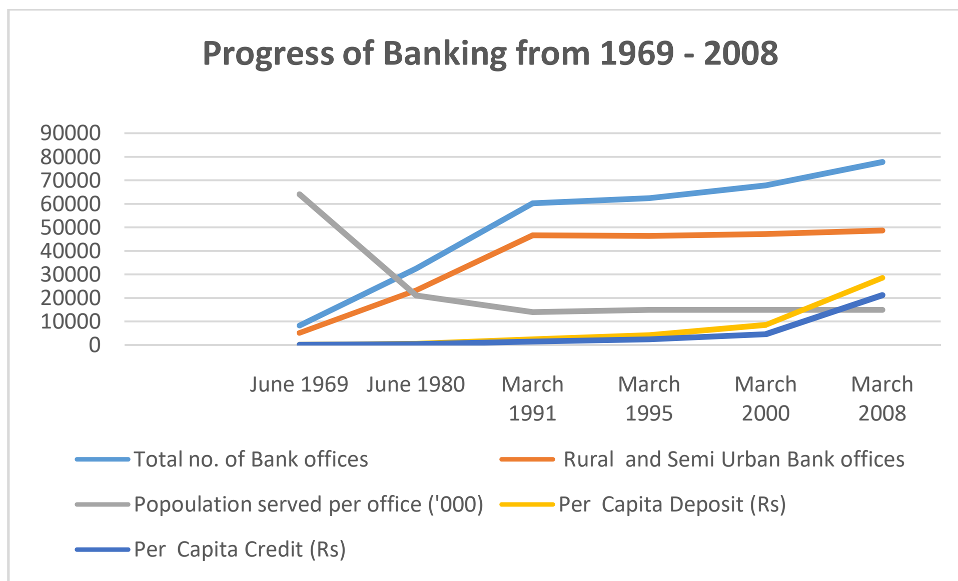



**Figure 3.13 | Source:** Handbook of Statistics on Indian Economy 2018-19

From June 1969 to June 1993m the total credit facility disbursed under priority sector lending jumped from a miniscule Rs 440 crores to Rs 47850 crores. The non-institutional share of credit in rural areas reduced from 68.3% in 1971 to 36% in 1991 (AIDIS, 1991 report). However subsidized interest rate resulted in digression of major portion of credit to the large farmers who leveraged their political and money power to influence the bankers and this worsened terms in the informal market on which the poor depend. [1]Adverse selection, moral hazards[2], difficulty of screening of borrowers, hassles of enforcement of contract, prevalence of impaired collateral made directed

[1] Adverse selection is the difficulty a banker faces in selecting borrowers with high credibility due to lack of information

[2] Moral Hazard is the risk that a banker faces when the borrower has executed the loan undertaking by providing false information regarding his assets and liabilities.

credit unviable. Frequent Loan Melas and Loan waivers served the political class but worsened the financial position of the banks and made the banking business unprofitable.

In 1991 there was a major policy shift from emphasis only on credit delivery to credit delivery with sustainability in order to stem the deteriorating financial health of the banks. Focus shifted to lowering the operational cost and increasing profitability of banks. Expansion through branch banking got substituted by expansion through alliances with third party agencies by leveraging of technology. Unviable branches were either closed or merged with the viable ones. Licenses were provided to private entities interested in entering the banking sector to usher competition and improvement in services. Opening of new branches and ATMs was deregulated by RBI while ensuring sufficient coverage to hitherto unbanked areas. Kisan Credit Cards were introduced to provide timely short-term credit to the farmers through single window.

NABARD, in 1992 conducted experiment with the Self-Help Group (SHG) model for efficient and low-cost outreach to the unbanked poor segment of the population. It was a partnership model between Bank, Self Help Group (SHG) and NGO where the SHG mobilized deposits from members and deposited it in the bank and the bank granted loan to the extent of certain multiple of the deposit. The NGOs role was to support the capacity building of SHG. It was a savings led credit disbursal vehicle for the poor based on social collateral.

In 2006, banks appointed Banking Facilitators and Business Correspondents for last mile connectivity based on the agency model. In the same year NABARD initiated a new model for lending to groups of tenant farmers and share croppers based on group guarantee for repayment. This was called the Joint Liability Group (JLG) model, where timely repayment was ensured through social collateral.

The Government has proactively encouraged the regulator to experiment and innovate new banking methods for credit delivery to the last leg of the population. Such methods were very effective in meeting the objective of Inclusive Finance. The mobilization of deposits by Scheduled Commercial Banks from rural and semi urban areas increased over the years as seen in **Table 3.4.** Between 1990 to 2018 the total number of deposit account in rural and semi-urban areas increased at a Compounded annual Growth Rate of 30 percent while the amount mobilized increased by 74 percent.

**Table No. 3.4 Deposit Mobilisation by SCBs in Rural & Semi Urban Areas**

| Deposit Mobilisation by SCBs in Rural & Semi Urban Areas | | | | |
|---|---|---|---|---|
| | Rural | | Semi Urban | |
| Years | Number of Accounts ('000) | Outstanding Amount (Rs Crores) | Number of Accounts ('000) | Outstanding Amount (Rs Crores) |
| 1990 | 102113 | 26234 | 92314 | 36370 |
| 1995 | 109944 | 51820 | 108129 | 71464 |
| 2000 | 125852 | 120539 | 114109 | 161972 |
| 2005 | 141908 | 213104 | 125198 | 295685 |
| 2010 | 224155 | 420338 | 189457 | 614047 |
| 2015 | 493970 | 915676 | 404661 | 1317251 |
| 2018 | 642225 | 1209786 | 568454 | 1851369 |

Source: Handbook of Statistics of the Indian Economy

With increase in number of branches in rural and semi-urban areas the credit outflow by Scheduled Commercial Bank also increased **(Table 3.5)**. Between1990 to 2018 the compounded annual growth rate in aggregate of credit accounts was 14 percent while the total credit outstanding increased by 74 percent.

**Table No.3.5**: **Credit Disbursal by SCBs in Rural & Semi Urban Areas**

| Credit Disbursal by SCBs in Rural & Semi Urban Areas | | | | | | |
|---|---|---|---|---|---|---|
| | Rural | | Semi Urban | | Rural + Semi Urban | |
| Years | Number of Accounts ('000) | Outstanding Amount (Rs Crores) | Number of Accounts ('000) | Outstanding Amount (Rs Crores) | Number of Accounts ('000) | Outstanding Amount (Rs Crores) |
| 1990 | 28401 | 25468 | 15459 | 17597 | 43860 | 43065 |
| 1995 | 29407 | 33529 | 16855 | 31807 | 46262 | 65336 |
| 2000 | 25080 | 59426 | 14865 | 64790 | 39945 | 124216 |
| 2005 | 29357 | 160479 | 18226 | 142836 | 47583 | 303315 |
| 2010 | 37074 | 385150 | 27047 | 367859 | 64121 | 753009 |
| 2015 | 52777 | 655361 | 39526 | 796609 | 92303 | 1451970 |
| 2018 | 59197 | 837817 | 53245 | 1239397 | 112442 | 2077214 |

**Source**: Handbook of Statistics of the Indian Economy

Despite multifold growth in the number of bank outlets, the credit outflow data compiled through All India Debt Investment Survey, 2002-03 revealed that percentage of credit from informal sources was as high as 42.9 per cent (Table 3.6). In 2013 report the share of non- institutional sources in household reduced to 36%. This points to the fact that population at the bottom of the pyramid were denied access to institutional lending despite all efforts. It needs to be probed as to why 36 per cent are denied access to formal credit.

**Table No.3.6: Percentage share of Institutional and Non-institutional Agencies in Outstanding Credit in Rural Areas**

| AIDIS Report | Institutional | Non-Institutional |
|---|---|---|
| 2012-13 | 64 | 36 |
| 2002-03 | 57.1 | 42.9 |
| 1991-92 | 64 | 36 |
| 1980-81 | 61.2 | 38.8 |

Source: RBI Reports

**Cooperative Banks**

India has a triple layer Rural Cooperative Credit System comprising of one Apex or State Co-operative Bank at the State level, District Co-operative Bank at the district level and Primary Co-operative Credit Societies at village level. The formidable outreach of co-operatives in remote location can be judged by the reality that there are 95238 primary agricultural cooperative credit societies at the grass-root level. At the middle level are 363 District Credit Cooperative Banks with 13000 branches while at the top are 33 State Cooperative Banks with more than 1000 branches**.** Cooperatives banks have huge rural coverage so they are important for satisfying the credit needs of the poor farmers. In the first two decades after independence the co-operatives were the only source of credit flow to rural areas.

The commencement of co-operatives in India was first advocated by The Famine Commission in 1901 to control the moneylenders who were charging usurious rates from the farmers. The Cooperative societies act came into effect in 1904 which defined the guidelines for organization of credit cooperatives and special rights conferred to them. The scope of this act was widened by Cooperative Societies Act 1912 which was more exhaustive. The Maclagan Committee (1915) expressed hope that every village should have at least one cooperative. Government of India act 1919 empowered the provinces to frame their respective cooperative rules. Later, The Multi-Unit Cooperative Societies Act 1942 was passed by the then British Administration to administer those co-operatives which operated in more than one province.

After Independence different laws were enacted by different state governments because co-operation remained a state subject. This Multi -Unit Co-operative Societies act was later superseded by Multi States Cooperative Societies Act 1984.

The co-operatives are the chosen vehicle for development of unprivileged class because they are member owned and member driven structure with self -imposed limitation on profit. Their non-exploitative nature makes them a credible institution for development. They became a trusted partner in the Government's goal of social development After independence growth with equity became the goal of the Government and co-operatives became a trusted partner in the growth because of their non-exploitative credentials.

In 1951, report by the All-India Rural Credit Survey noted that cooperatives in the country have failed to emancipate the farmers from the grip of the moneylenders. Nearly 75.2% of rural credit requirement were met from informal sources. The report highlighted that in many parts of the country there were no co-operatives and in areas where co-operatives were present, a major proportion of the farm population remained deprived of its membership. The survey took note of the growing weaknesses of Cooperative Banks and recommended that Commercial Banks should also supplement the Cooperative Banks in lending to the deprived segments of the society.

Over the years the loan advanced by Cooperatives has increased as seen in **Table 3.7**. However, the share of the cooperatives in total agriculture credit has reduced over the years and that of Scheduled Commercial Banks have increased as seen in **(Figure 3.14)**.

**Table 3.7:** Loans and Advances OF PACS, SCARDBs AND PCARDBs (Amount in Rs Crores)

| LOANS AND ADVANCES OF PACS, SCARDBs AND PCARDBs (Amount in Rs Crores) | | | | | |
|---|---|---|---|---|---|
| | PACS | | SCARDB | | PCARDB |
| | **Amount Advanced** | **Amount Outstanding** | **Amount Advanced** | **Amount Outstanding** | **Amount Advanced** |
| **1986-87** | 3304 | 4732 | 203 | 301 | 354 |
| **1990-91** | 4311 | 6486 | 384 | 1348 | 376 |
| **1995-96** | 10552 | 12980 | 1798 | 6857 | 1219 |
| **2000-01** | 25698 | 34522 | 2586 | 12596 | 1866 |
| **2005-06** | 42920 | 51779 | 2907 | 17678 | 2296 |
| **2010-11** | 91304 | 87768 | 3911 | 18457 | 3324 |
| **2015-16** | 180823 | 158487 | 5237 | 20409 | 5642 |
| **2017-18** | Data Not Available | Data Not Available | 4502 | 20788 | 4470 |

**Source:** Handbook of Statistics of the Indian Economy 2018-19

**Weaknesses of Co-operative Banks**

The cooperative banks suffered from many weaknesses. They lacked the professionalism required for independent assessment of credit worthiness and loans were often given to the members on political recommendations. The co-operative structure was overburdened with over dues to such levels that the entire capital was eroded and there were no resources for providing advances. The Government infused share capital for revival and de-facto took over the Ownership, Governance and Management of the bank. The banks thus, ceased to be a member driven organization and became an extended arm of the Government. The Management and employees of the bank were no longer responsible to the members but behaved like their Patrons. Over the years Cooperatives became financially weak and total institutional credit declined **(Figure 3.14)**

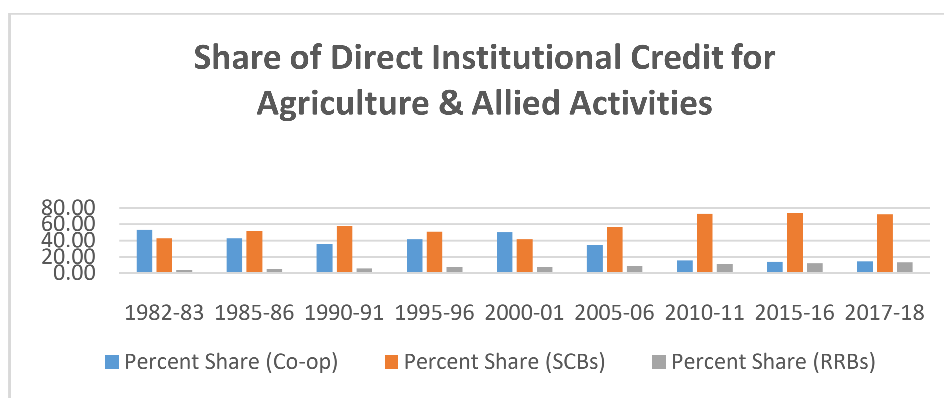



**Figure 3.14:** Cumulative Performance of State Cooperative Banks **|** Source: Handbook of Statistics on Indian Economy 2018-19

Intermittent waiver of loans further weakened the co-operative banks. Loan waiver scheme for farmers by the Government in 1989 destroyed the financial health of the cooperatives. The populist policies of political parties in power dealt severe blow to the growth of the cooperative banks.

The PACs operate at village level in a very limited geographical area at low margins which restricts them from achieving the benefit of economy of scale. They hardly mobilise rural deposits e and serve as a vehicle for distribution of credit. Because of their inability to mobilise deposits the PACS could never become self-reliant autonomous institutions. Being a Government driven organisation, members have almost no stake in the co-operative which creates discord and encourages corruption.

Government subsidies have eroded the business-oriented approach of co-operatives which is evident from the fact that the Agricultural Credit Review Committee, 1989 reported that, the net interest margin of PACS is 3.21% point less than the mark-up required to recover the cost of operations. ACRC advised the interest margin should be sufficient enough to cover not only the cost of resources but also cover the expenses incurred on servicing and supervision.

Various committees set up by the Government have advocated developing the co-operatives as a self- sustaining member driven independent organisations. The Vaidya Nathan Committee while acknowledging the outreach potential of co-operative credit societies suggested strengthening them through recapitalization and leveraging technology so that they can provide fast, efficient and

economical service. The Committee also advised that there should be sufficient spread to recover the operational costs and remain profitable.

The committee favoured bringing the cooperatives from the regulatory authority of States to RBI as per the provision of the banking regulation act 1949. However, the states were not enthusiastic to relinquish their regulatory power to RBI. In 1995 the state of Andhra Pradesh enacted the Mutually Aided Cooperative Societies Act which aims to make the co-operatives structure member driven, democratic and self-sustainable and independent of any financial support by the state. There was provision for cooperatives registered under old law to shift to the new law.

The Vaidya Nathan committee also observed that credit cooperatives are reluctant to convert to the Mutually Aided Cooperative Societies Act because this act did not have any arrangement for refinance. The committee also noted that government must refrain from participation and intervention in the in-house matters of co-operatives.

Based on Vaidya Nathan Committee report, the Government has granted licence to the unlicensed co-operative banks after infusing capital. At present all State Cooperative banks except one have been provided with licence; the number of unlicensed DCCBs is only three. Efforts are going on to recapitalise Daman & Diu State Co-operative Banks and three DCCBs in Jammu and Kashmir after which licences would be issued to them.

Cooperative Banks, due to their huge presence in villages, are significant player in the multi- agency approach towards achieving financial inclusion. All efforts are being pursued to make the co-operatives sustainable through injection of fresh Capital and by instilling business-like approach with profitability as the focal point. In summary the cooperative has not been successful in being viable because of limited geographical coverage, restricted product choice, political interference in loan sanctions, lack of professionalism, half-hearted follow up for loan repayment and poor governance structure.

### Regional Rural Banks

The Regional Rural Banks came up in 1975 primarily as a low-cost alternative to commercial bank branches and to fill the gap that existed in meeting the credit demand in rural areas. They were the consequence of recommendation of the Narasimham Committee report.

The vision behind recommending the formation of Regional Rural Banks is as follows:

I. Even though there is a wide network of banks in rural areas still there is a gap in fulfilling the credit needs.
II. The commercial banks are not efficient in serving the credit needs of the poor because of various reasons like high-cost structure, manpower quality and mind-set of employees towards rural credit.
III. The cooperative banks were not competent to fulfil the total requirement of rural credit.
IV. There was a need for bank which would have the grass-root familiarity of a cooperative bank and professional features of a commercial bank.

The function of Regional Rural Banks is:

I. To increase the banking outreach to unbanked remote areas

II. To channelize credit at affordable rates to the vulnerable strata of the society

III. To provide a savings vehicle for rural masses and deploy them for rural growth.

IV. To trigger avenues for employment in rural areas

V. To promote low cost banking in rural areas.

The ownership of RRB is distributed in ratio of 50:15:35 between the Central Government, respective State Government and the Sponsor Bank.

Between 1975 to 1987, there was rapid growth in the number of RRBs, rising from six to one hundred ninety six. Normally a single RRB operated within 1-3 districts and together they covered 518 districts. Cumulatively 196 RRBs had 14446 branches covering 23 states in the country. Thus RRBs gradually became an indispensable channel for rural credit delivery.

RRBs are expected to be financial institution operating exclusively in rural areas. They would possess the rural reach like the co-operatives and professionalism of commercial banks. Almost Ninety seven percent of RRBs branches are located in rural and semi-urban areas

Though RRBs were foreseen as vehicle operating on low cost banking model, it did not materialise because National Industrial Tribunal upheld the demand of RRB employees that their pay package should be similar to that of commercial bank. As a consequence the administrative and other expenses increased beyond the income earned by them, resulting in losses.

Restrictions regarding the geographical area of operation and the small ticket size of advances generated very little revenue for the branch which affected its viability. Non repayment of loan and poor recovery added to the woes.

The customer base was confined to rural poor, which also limited the scope of working on high margins to cover the costs and overheads. Administered interest rates hardly provided adequate margin to cover risk cost and cost of service and operations.

Lack of professionalism and business orientation and aggressive trade union were other issues which affected the performance of RRBs.

Post 1990s various initiatives for improvement were initiated to stem the mounting losses and capital erosion of RRBs based on recommendation by Narasimham Committee report. These reform measures were:

1. RRBs for the first time were given the permission to move beyond financing the farmers and the poor to providing loans to the non-farm sector and non- weaker section, up to 60% of fresh lendings from January 1994. This was meant to broad base the business opportunities for the RRBs. Later, the norms for priority sector lending ,as applicable to commercial banks , was extended to the RRBs and the classification of target and non- target group was abolished.
2. Injection of fresh Capital by the Government to make the RRBs viable.
3. Relocation of branches which were making losses for more than three years.
4. Revamp the loan products mix to include products which offer better margin e.g. gold loan, loan for consumer durable, deposit linked loan etc. The banks could broad-base its business and client services.

5. Create opportunities for non- fund business e.g like renting safe deposit lockers, issuing gift cheque and demand draft, discount of Demand draft and cheques etc.
6. RRBs which had poor track of disbursing loans were unshackled from service area obligations.

Consolidation and amalgamation of RRBs was necessary to make them viable by reducing operating overhead. Enhancing capital and expanding the scope of operation of RRBs were the other steps taken for their sustainable operation. The process of mergers and recapitalisation of RRBS gained momentum from 2005 onwards. The number of RRBs reduced drastically from 196 to 45 as at April 1, 2019. Further consolidation is in process. ₹235 crores were allocated in the union budget of 2019-20, for recapitalisation of RRBs in order to empower them to fulfil regulatory conditions.

In 2015 the government amended the Regional Rural Act,1976 , with the intention to increase the authorised and issued share capital of RRBs and to enable them to raise equity capital from external sources other than central government, state government and sponsor bank.

In order to promote low cost outreach for the RRBs the Reserve Bank initiated the idea of banking outlet (BO) in May 2019. It defines BO as a fixed-point service delivery unit which is operated either by the bank's staff or its business correspondent for a minimum of four hours every day for minimum five days a week and where basic banking services are provided like acceptance of deposits, redemption of cheques/cash withdrawal or lending of advances.

Over the years the deposit mobilisation and credit disbursal by the RRBs have increased as seen in **Table 3.8.** The deposit and Credit disbursal have grown at a Compounded Annual Growth Rate (CAGR) of 69 percent and 63 percent respectively

**Table 3.8 Regional Rural Banks-Outstanding**

| Regional Rural Banks-Outstanding (Crores Rupees) | | | | |
|---|---|---|---|---|
| Year | Deposit | | | Bank Credit |
| | Demand | Time | Aggregate | |
| **1989-90** | 817 | 2998 | 3815 | 3409 |
| **1990-91** | 941 | 3619 | 4560 | 3497 |
| **1995-96** | 2475 | 10895 | 13370 | 7289 |
| **2000-01** | 6098 | 29897 | 35995 | 15211 |
| **2005-06** | 17355 | 46840 | 64195 | 36050 |
| **2010-11** | 33663 | 123039 | 156702 | 94545 |
| **2015-16** | 50916 | 242839 | 293754 | 197111 |
| **2018-19** | 70087 | 355712 | 425799 | 276345 |

Source: Handbook of Statistics of the Indian Economy 2018-19

However, the quality of credit has declined since 2015 and impaired assets have increased. The number of RRBs earning profit has declined from 49 to 45 between 2016-17 and 2017-18. The cumulative net profit of RRBs has been declined by 32% during the same period. Adjusting for the accumulated

losses of previous years the overall losses is Rs 1866 crores as on 31st March 2018 **(Table 8)**. Rising NPAs is the prime reason for RRBs incurring losses.

**Table 3.9 Profitability of RRBs as on 31st March**

| Profitability of RRBs as on 31st March | | |
|---|---|---|
| **Particulars** | **2017** | **2018** |
| **RRBs earning profit (no.)** | 49 | 45 |
| **Profit (Rs) Crore (A)** | 2,604 | 2,506 |
| **RRBs incurring losses** | 7 | 11 |
| **Losses (Rs) Crores(B)** | 386 | 1,005 |
| **Net Profit of RRBs (Rs Crores) (A-B)** | 2,218 | 1,501 |
| **RRBs with accumulated losses(no.)** | 8 | 11 |
| **Accumulated losses (Rs Crores)** | 1,147 | 1,866 |

Source NABARD

RRBs are important institution for distribution of credit in rural areas because of their extensive geographical spread and closeness to grass root level clients. They are an important player in driving the Government's financial inclusion agenda in secluded locations where commercial banks fail to reach. The concept of local recruitment of staff makes them familiar with the local economy. They also aggregate low-cost deposits from clients in remote locations which are out of reach of commercial banks. Considering their importance, the priority sector guideline was modified for them to 75 percent of total loan outstanding.

Constraints related to service area, client type, small array of products, low value transactions and low margins deterred the RRBs from exploiting their business potential and achieving self-sustenance. However Regional Rural Banks offer a huge potential for growth of banking business in rural areas provided the weaknesses are mitigated

**Sustenance and Way Forward for Co-operative Banks & Regional Rural Banks**

Co-operative Banks exist in India since pre-independence when they were the only vehicles for delivering rural credit. The PACS are the basic and smallest co-operative credit institution in India. There are nearly 95200 PACs in the country which translates that one out of every six village has a PACs. This shows that the co-operatives have a huge coverage and if they are governed professionally, they can become a potent vehicle for credit distribution in rural areas. Their familiarity with the ground level also makes them useful as a medium for loan dissemination and deposit mobilisation in villages.

The co-operative should be allowed to function under the Co-operative Principles as an independent institution and interference of Government should be discouraged. They should stand on their own feet as a profitable business entity without the support from Government. They have to become a member driven organisation and not a Government driven organisation. The credit appraisal system should be strengthened and loans should be given without being influenced by political pressures. This would help them to generate profit and enable them to be sustainable. Deposit mobilisation should be emphasised to make the PACS more sustainable business entity. Frequent trainings should be provided to the staff to increase their professionalism and business orientation.

Government should discourage loan waivers which causes adverse effect on credit culture. The dual control structure of the co-operatives should be dismantled. Presently they are controlled by State Government as well as the RBI which is one of the causes of poor regulatory control.

The Regional Rural banks have also become a very robust institution with large rural spread and efforts should be made to make them profitable. The government has favoured the consolidation and recapitalisation route to make the RRBs viable which is a step in the right direction. The basket of products has been increased and now RRBs can sell all products at par with public sector banks except that they cannot deal in foreign exchange. However, the staff should be trained frequently to instil in them a sense of professionalism and business acumen so that they become sensitive to issues related to loan defaults and loan losses. The credit appraisal mechanism also needs to be strengthened to control the instances of loan default and generation of impaired assets.

## Summary

1. Crop loan system forms a part of the farm credit. It is the loan given to farmers for Seasonal Agricultural Operations.
2. The crop loan is availed from Institutional as well as Non-Institutional sources. The non-institutional sources include relatives and friends, input suppliers, landlords and moneylenders.
3. When we refer to institutional sources there are three agencies which deliver rural credit namely, the commercial banks, co-operative banks and regional rural banks.
4. The loan is fixed based on area of cultivation and type of crop. In other words, the loan per unit area which is called the scale of finance is fixed for different type and varieties of crop
5. Tenant farmers and share croppers can be financed in case of crop loan. Having title to the land is not essential.
6. Crop Loans are given without collateral up to Rs 160000 and no margin money is required to be paid by the borrower.
7. Crop loans are also disbursed through Joint Liability groups through two different models – Financing Individuals in the Group and Financings the Group.
8. Cooperatives are one of the vehicles for delivery of short-term credit to agriculture, the other two being Commercial banks and Regional Rural Banks.
9. Rural Cooperatives Credit Structure comprises of three levels- Primary Agriculture Cooperatives at village level, District Central Cooperative at District level and State Cooperative Banks at the State Level.
10. There has been an overall decline in the contribution of cooperative banks in the distribution of rural credit.
11. Kisan Credit Card scheme was introduced in 1998 as per RBI direction to the banks. The three agencies identified for implementing the scheme are the Commercial banks, Co-operative Banks and Regional Rural Banks.
12. Kisan Credit Card is a simplified way of disbursing crop loan and term loan. The loan limit consists of two parts; first part is the short-term loan or crop loan payable in one year while the second part is the term loan payable in five years period.
13. The credit limit is set for tenure of five years with sub-limits for annual withdrawal of crop loan Portion.
14. For Tenant farmer and share croppers the KCC limit is restricted to Rs 50000 only.

15. Agriculture in India is not only dependent on supply of credit to farmers but it is plagued by other issues also.
16. These issues pertain to input requirements like quality of seeds, fertilizers, pesticides, irrigation facilities, market requirement.
17. Long term needs pertains to mechanization of agriculture and other investment required.
18. Increasing subsidy expenses is a challenge for the Government. It is the biggest subsidy after food subsidy and efforts are going on to restrict the same.
19. Excessive and imbalanced use of urea has led to a loss of fertility in the soil which is another challenge.
20. The excessive use of low-quality pesticides and lack of awareness about pesticide is the cause of deterioration in soil and environment health.
21. Agriculture sector requires markets with proper infrastructure near to the farm gate so that the farmer gets remunerative prices and the rural economy benefits from growth in employment
22. Mechanization helps in efficient utilization of agricultural inputs like seeds, fertilizers, chemicals & pesticides and natural resources like water, soil nutrients etc.
23. Till 1990, three agencies -Commercial Banks, Cooperative Banks and the Regional Rural banks, formed the backbone for banking outreach to the remote unbanked areas of the country.
24. The number of banks is semi-urban and rural areas rose rapidly and so also the rural credit delivery increased.
25. However, increase in bad loan and poor recovery efforts led to loss of profitability and capital erosion of all the banks.
26. Regional rural banks performed poorly because of restriction in operational area and very limited basket of products which could bring business profitability.
27. Post 1990, focus shifted from credit disbursement to profitability of the banks and hence there were closure and mergers of non-profitable branches. Permission was accorded for setting up private banks.
28. Expansion through branch banking got substituted by expansion through alliances with third party agencies by leveraging of technology.
29. In 2013 AIDIS report the share of Non Institutional agencies in household credit reduced to 36%.

**Model Questions**

I. What are the unique features of crop loan?
II. What is JLG model and what are the different types of JLG model?
III. What are the problems in Indian Agriculture, other than supply of credit?
IV. What was the reason for failure of cooperative banks?
V. Why did the scheduled commercial banks run into losses?
VI. Why did banks change their business model after 1990?

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# Chapter 4 Rural Banking-Legal and Regulatory Framework Number

## Introduction

There is a legal and regulatory mechanism which governs the functioning of the banks. In traditional parlance, banking has only two functions – Mobilizing deposits and extending credit to its customer. However, bankers are now providing services which go to the extent of providing tax consultancy or investment planning consultancy to its clients. The legal relationship between the bank and its customer varies according to the nature of services it provides. The bank can act as a debtor or creditor, agent, trustee or licensor based on the services it provides to its customer. In each of this relationship with customer the bank enjoys certain rights and also performs certain obligation for its customer.

The basic guiding principle for all firms engaged in banking business is laid down in the Banking Regulation Act 1949. It is the foundation for Indian Banking rules and regulation. Further, the Credit Co-operative Societies which plays an important role in dispensing rural credit are governed specifically by the Co-operative Societies Act. It facilitates the formation and democratic governance of member owned Co-operatives. The Negotiable Instruments act 1881 lays down the guidelines for those banking instruments which promise a sum of payment to a person or assignee like a promissory note or cheques. To prevent money laundering and terror financing, Government promulgated the Anti- Money Laundering Act in 2002. Through this act and Banking regulation act, Government issues the Know You Customer Guidelines which needs to be adhered to before opening a customer's account or before extending loan or any other services to a customer.

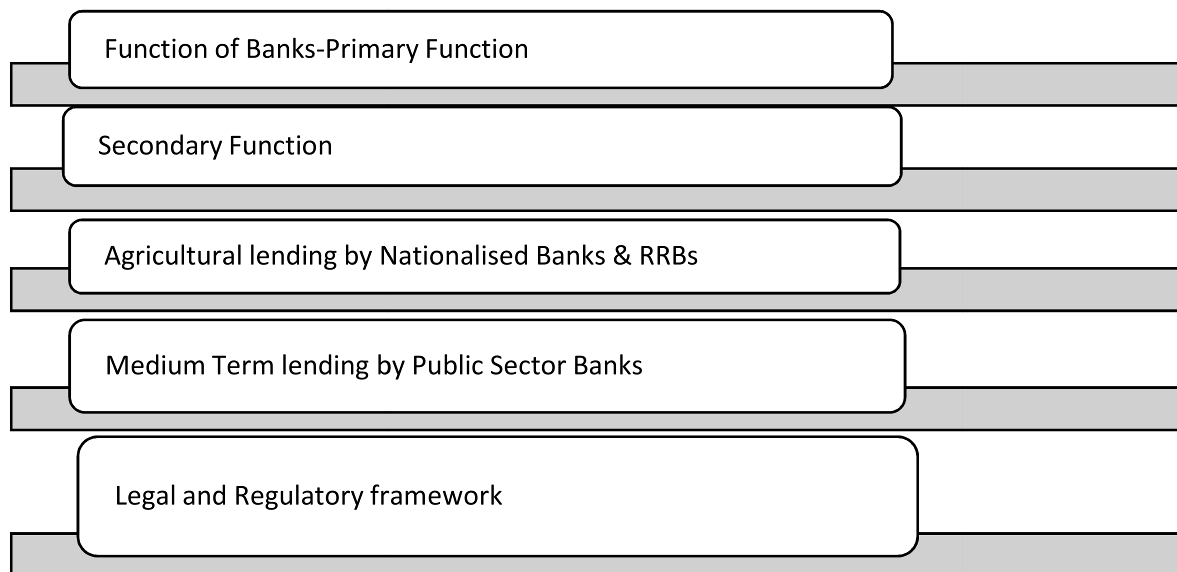
The Nationalized Banks and Regional Rural Banks have played a commendable role in dispensing agricultural credit. Among the three agencies delivering rural credit Nationalized banks have the maximum share followed by the Regional Rural Banks. However, RRBs are facing challenges due to poor loan recovery and diminishing profits and many under-performing RRBs have been merged with their better counterparts to improve the performance. The apex supervisory and regulatory bodies like RBI and NABARD have made laudable contribution towards evolving a well-documented policy for smooth flow of rural credit, linked with production to increase the income of rural population.

## Objectives

The objectives of this chapter are:

- To familiarize primary function of banks
- To familiarize secondary function of banks
- To acquaint with agricultural lending and limitations of RRBs
- To explore medium term lending
- To provide an understanding of legal and regulatory framework

**Structure**




## 4.1 Function of Banks

Banks are financial intermediaries which provide different services to the customers. In its pure form, banking is defined as a financial entity authorized to solicit deposits and make loans. Nowadays banks also deliver extended financial services such as wealth management, currency exchange, bank assurance and safe deposit boxes. These are the extended functions or secondary functions which the banks provide to its customers.

Banks play a very important role in the growth of the economy. They provide a safe place to store savings and earn interest on the savings. They pools the savings and invests it in businesses which are in need for fund. In this manner the banks provide credit opportunities for people and businesses who require funds. Thus, they create liquidity in the market and keep the market moving.

Banks may be classified into different types like retail banks, development banks, and investment banks. Detailed classification is given in **Figure 4.1**. In most countries, there is a regulatory authority appointed by the government to regulate the banking sector. In India Reserve Bank of India is the regulatory authority for all banks

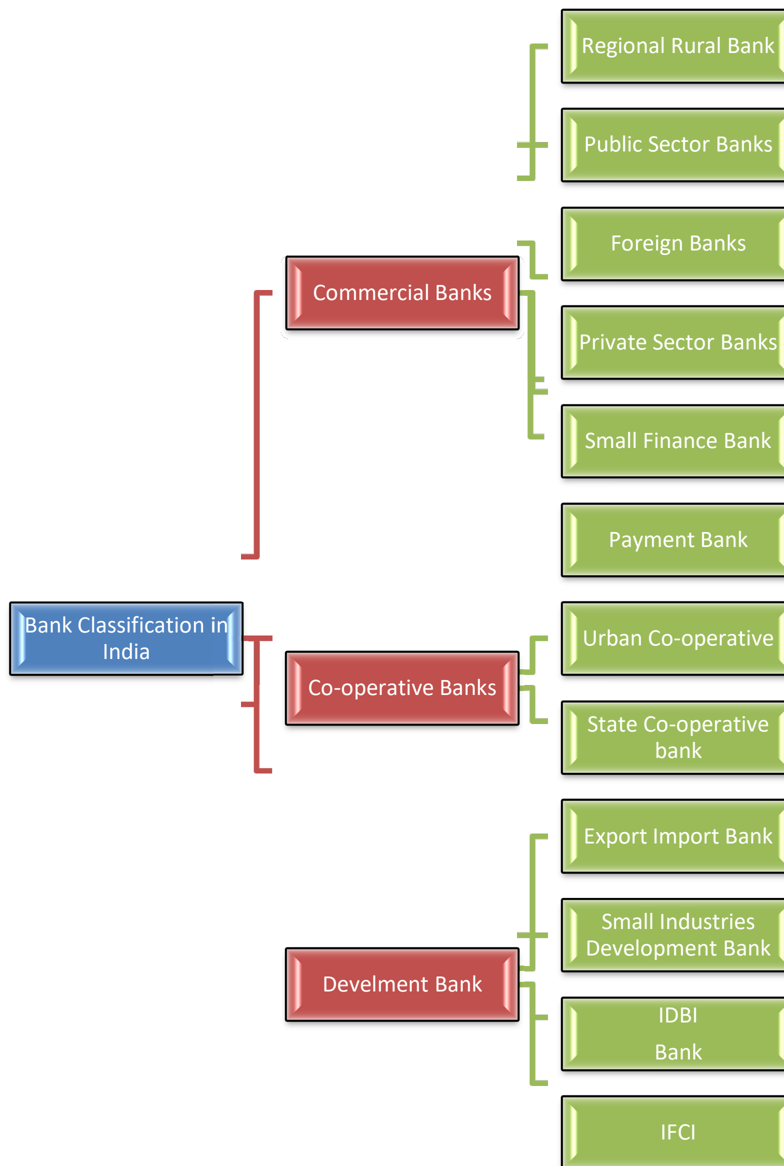



**Figure 4.1:** Classification of Banks in India | **Source:** Prepared by Author

**Primary Function of Banks**

The essential functions of banking can be divided in two parts:

1. Accepting deposit from customers
2. Lending money to customers

**Deposit Mobilization**

Deposit account forms the major source of fund for the bank and occupies the liabilities side of the balance sheet. Deposit product is extended to customers by the bank to generate funds for financing the asset side of the balance sheet. Deposit mobilized by banks is loaned to customers who are in need for funds and the interest received from loans form the revenue of the bank, which is known as the interest income. The difference between the Interest earned on loans and Interest paid on deposit is the Net Interest Income of the bank.

Interest rate provided by the bank on deposits varies from time to time based on the asset-liability level which the banks wish to nurture. The terms and conditions related to deposit product depends entirely on the liquidity position that the bank requires, quality of its assets and time frame it needs to meet various payment commitments. Deposit products are further divided into three groups: Demand, Term and Hybrid deposits (**Figure 4.2**). Demand and term deposit of the bank constitutes the demand and time liabilities which, as per the regulatory guidelines the bank reports every week (on every Friday) to the RBI. Banks have to invest a certain portion of its demand and time liabilities in liquid assets like Government bonds and approved securities. The ratio of the investment in liquid assets to demand and time liabilities is known as Statutory Liquidity Ratio.

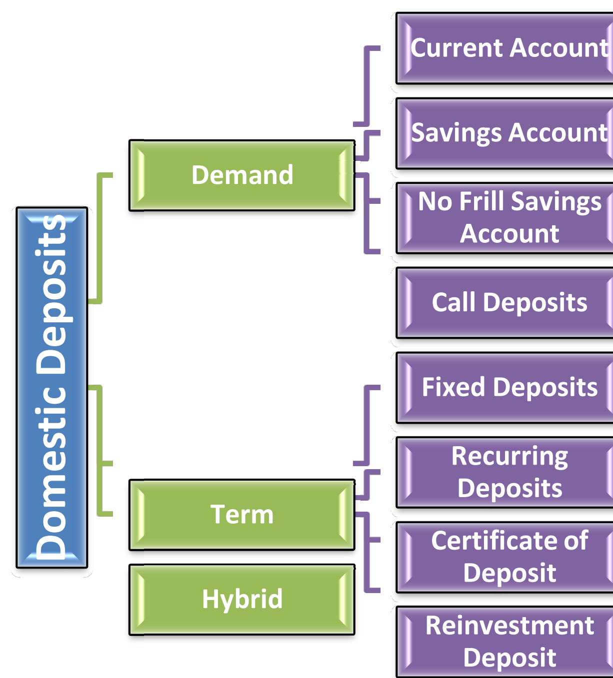



**Figure 4.2:** Classification of Deposits **| Source:** Prepared by Author

**Demand Deposit**

Demand deposit are those deposits that can be withdrawn or transferred by the customer without previous notice to the bank. The withdrawal or transfer from the account happens on customer's demand. They are further classified as:

1. **Current Deposit Account-** These are a part of demand deposit portfolio of the bank. The aim of current account is to impart ease of operation to the customer since it frees them from the risk of handling cash. There is very little or no limits on withdrawals either in terms of frequency or amount. Current account can be opened by individual, proprietary firm, partnership firm, private and public limited companies, trust, societies, government bodies etc. The banker is committed to repay the liability when demanded by the customer. Since the number of payment and collection transactions in the current account is very high the bank sustains high cost in handling the account and so interest is not paid by banks on current account balances. Cheque issuance, bill collection and payment facilities are permitted to the current account holders. Some banks collect fees for administering the

current account while others may not collect any charge but warrant that a minimum specified balance to be maintained.

2. **Savings bank account–** These accounts are targeted to those customers who have surplus from their current income and wish to save the surplus and earn an income. These accounts are aimed to encourage savings habit. Like current account cash withdrawals are permitted on demand. Some salient features of the savings account are:

    I. Some Banks may have restriction on the number of withdrawals per period e.g., per month or per quarter. Penalty may be levied for violating the norms.
    II. Banks may prescribe minimum balances primarily to offset the cost of managing and maintaining the account.
    III. Savings account cannot be started by a trading or business firm. Even Government departments, Municipal bodies, panchayats, state housing boards, water and sewerage boards, metropolitan development authority etc. are prohibited from opening a savings bank account.

3. **No Frill Savings Bank Account-** The No Frill Savings account, also known as BSBD account or Jan-Dhan account were introduced with the focus on achieving deeper level of financial inclusion. These accounts are available to promote basic banking amongst the unbanked segment of the population who are otherwise unable to comply with the terms and conditions for opening a normal savings account. The account allows to keep very minimum or nil balance with a five to ten transactions per month. They can use the ATM facility. The KYC norms are also relaxed because often the poor unbanked customers are unable to produce required documents to prove their identity and residence address. The cash balance in such account should not be more than Rs 50000 in a year. In case the customer lacks the required documents for due diligence these accounts can be opened by obtaining introduction of other bank account holder whose account is fully KYC compliant.
4. **Deposit on Call Account –** Call deposits transactions occur between two banks. The account of one bank is maintained with another peer bank, and the former can withdraw cash on demand. Since the size of the deposit is big some banks prefer the customer bank giving prior intimation of a week or less prior to the demand for withdrawal.

**Term Deposits**

A deposit account where the customer consents to engage the deposit amount for a fixed term with the bank is called a term deposit account. Term deposit account can be started by individual as well as business firms which may be proprietary or partnership or private and public limited companies, trust, societies etc. The rate of interest and tenor applicable on such deposits differs from bank to bank. The interest rate on the deposit can be either fixed or floating. Fixed rate means the interest is same for the entire tenure of the deposit during the period of the contract whereas floating rate means that the rate is pegged to a varying bench mark rate while entering into a contract agreement. Floating rate will thus vary with the variation in the benchmark rate specified in the contract. The bank provides a term deposit receipt as an acknowledgement of having received the term deposit amount. The term deposits may be further classified as:

1. **Recurring Deposits** – Under this scheme a fixed sum agreed upon by the banker and customer will be deposited by the customer every month for a fixed tenor. At the end of the

tenor the depositor will be repaid the total deposit instalments with interest. It is a tool to instill regular savings habit amongst customers.

2. **Reinvestment Deposit Scheme-**Under this scheme a lump-sum amount is invested for a fixed period which is repaid back with interest at the end of the period. Normally quarterly Interest is paid on such deposit and since that interest is not withdrawn at the end of every quarter, there is compounding of interest, hence the value at maturity would be higher than in case of similar schemes.

3. **Certificate of deposits-**Certificate of Deposits were introduced in 1989 to provide investors the opportunity to invest surplus fund for a short period. The main difference between reinvestment deposit and certificate of deposit is that the latter is a negotiable instrument while the former is nonnegotiable instrument. The certificate of deposits are issued in dematerialized form or in form of promissory notes for money kept in the bank for a specified period. The Bank can issue CD with a minimum of Rs 100000 per subscriber or in multiples of Rs 100000. CDs can be issued to individuals, corporation, companies, trust, associations etc. Since CDs are categorized as money market instruments their maturity cannot exceed 1 years. The minimum period of issue would not be less than seven days. CDs are commonly issued at a discount on the face value, which is also the value at maturity. There is no minimum lock in period and they can be transferred by endorsement and delivery.

4. **Fixed Deposit Scheme –** A specific amount is deposited for a fixed term during which the amount usually cannot be withdrawn. However, based on request from depositor interest can be paid either monthly or quarterly or half-yearly or on an annual basis. The depositor can earn regular income from fixed investment. Unlike reinvestment deposit scheme there is no compounding of interest in fixed deposit scheme.

**Hybrid Deposits**

Hybrid Deposits or flexi-deposits incorporate the characteristics of demand and term deposits. They are combo products which have the flavor of demand deposits as well as term deposits. These products are meant to combine the need for convenience in transactions without having to handle cash and also earning an income.

I. Multi Option deposit scheme-It is a fusion of demand deposit and fixed deposit. The customer needs to open either a savings or current account. The minimum balance to be kept in the current account or savings account is fixed and if the balance at any point of time surpasses the pre-decided amount the excess portion is moved to fixed deposit account of a predetermined maturity which is normally one year. This transfer from the demand deposit account to a fixed deposit account is called sweep. In the event of the balance in current or savings account falling short of the pre-determined amount, the money from the fixed deposit account is transferred back. This is called reverse sweep. This product allows the depositor to earn higher interest income on the fixed deposit. When there is reverse sweep a part of the fixed deposit account is broken prematurely so the interest income gets reduced. However, the balance amount which remains in fixed deposit account continues to receive interest at the original rate.

II. Advantage deposit scheme-This is an innovative product combining the key features of fixed deposit and mutual fund. The customer enjoys the assured return on fixed deposit and

higher return on equity fund. The monthly interest income from fixed deposit is transferred to mutual fund through systematic investment plan.

III. Insurance linked deposit schemes- In order to open more savings account banks often provide accident insurance to its depositors either as freebie or at a discounted rate under group insurance scheme. These are special schemes floated as a marketing strategy. Some banks provide accident insurance to new depositors for a period of one year and thereafter starts charging premium from subsequent years.

**Deposit Scheme for Non- Resident Indians**

These are deposits which allow the Indian Nationals staying abroad and the Overseas Corporate Bodies to invest Indian Banks. The Overseas Corporate Bodies are business firms which are predominantly owned by Non-Resident Indians. To avail these deposit schemes for NRIs the depositor has to meet any one of the following criteria:

I. He should be an Indian citizen who stays in a foreign country either for purpose of employment or for business purpose or for any other purpose, suggesting an indeterminate period of stay outside India.

II. He should be an Indian citizen working in a foreign country with International organizations such as United Nations, World Bank, IMF etc.

III. He should be an employee of Central or State Government or public enterprises on deputation to abroad on a temporary assignment.

IV. He may be a person of Indian origin meaning that he has either been an Indian passport holder at any time in the past or he or either of his parent or any of his grandparents were Indian citizens or his/her spouse is an Indian citizen or a Person of Indian Origin.

V. Overseas corporate bodies can also maintain deposit account with Indian banks. An OCB is defined as a company, partnership firm, society or any other corporate body where the Non-Resident Indians have stake of 60 percent or above.

The most defining feature of NRI accounts is that they are absolved from many taxes like Income tax, wealth tax and gift tax. Banks can extend credit to NRIs by keeping the deposits in the account as security money. The different types of accounts that can be opened by NRI and their differentiating features are mentioned in **Table 4.1.**

**Table 4.1:** Essential Features of NRI accounts

| Ordinary Non Resident (NRO) | Non Resident External Accounts | FCNR(B)Scheme |
|---|---|---|
| Rupee Account | Rupee Account | Maintained in any convertible currency |
| Exchange risk implied | Exchange risk implied | No Exchange Risk |
| Collects fund from local transaction | Collects fund from remittances transferred from abroad | Collects fund from remittances transferred from abroad in foreign currency |
| Non-Repartiable Account | Repartiable Account[3] | Repartiable Account |
| Savings/Current /recurring /term deposit | Savings/Current /Recurring/term deposit | term deposit format |

[3] Repartiable refers to the ability to move liquid financial assets from a foreign country to an investor's country of origin.

**Know Your Customer Policy**

The KYC rules were first set-in motion in 2002 by the Reserve Bank of India for all banks. In 2004, it set December 31, 2005 as the deadline by which all banks had to be fully compliant with the KYC provisions. The KYC guidelines were a part of the broader Anti-Money Laundering (AML) policy of the banks. The purpose of KYC was to curb the flow of illegal money, terrorist financing and theft. It protects banks from being used as channel for transacting money earned through illegitimate means so that it appears to have originated from legitimate sources.

KYC policy guidelines define the Customer of a bank as:

I. An individual or an entity that has an account or business relationship with the bank.
II. A Beneficial owner on whose behalf the account is maintained by legal representatives. The beneficial owner is the natural person who controls the account;
III. A Recipient of the benefits of transactions carried out by professional intermediaries' e.g., Stock Brokers, Chartered Accountants, lawyers etc.;
IV. Any person or entity related to financial dealings which can give rise to significant reputational or other risk to the bank e. g issue of a high value DD as a single transaction.

The following are three key features of KYC Policy pursued by the banks

1. **Customer Acceptance**- When a bank receives application from a prospective client to open an account it has to follow the following procedures:
   i. Classify customers into various risk categories based on the perceived risk derived from the nature of business activity, location of customer, social status etc. The level of due diligence will rest upon the perceived risk classification in which the customer is categorized by the bank.
   ii. Verify the identity of prospective customer based on guidelines defined.
   iii. Collect requisite documents for verification for various classes of customers based on the risk discernment and as per guidelines of Prevention of Money Laundering Act, 2002 and RBI Instruction circulated time to time.
   iv. Collect only those document and information which is pertinent to the risk classification of the customer and not be too interfering. The intent is to understand the customer and not to harass him.
   v. Not to open an account when the customer fails in due diligence checks i.e. bank could not verify the customer, the customer could not provide documents as required by his risk category or gave suspicious or unreliable information etc.
   vi. Not to deny banking services to eligible masses specially those who are from deprived socio-economic background.
   vii. Not to open fictitious or anonymous account.
   viii. Check that identity of customer does not match someone having criminal history or someone linked to debarred organizations.
   ix. Check that terms of operating the account is clearly illustrated and in adherence to the prevalent banking guidelines, where a person is permitted to act on behalf of an entity e.g., act on behalf of trust or corporate body
   x. keep the information provided by the customer confidential and not reveal it for cross selling or any other purpose

2. **Customer Identification-** Customer identification means validating the identity of the customer through documents and information supplied by dependable and authorized sources. The bank verifies documents and information issued by empowered sources to conform the identity of the customer. However, such inquiry should be commensurate to the risk profile so that there is balance between time and effort invested by the bank in scrutinizing and the difficulties sustained by the customer in collecting the documents. Documents will also vary for different types of customers like individual, legal entities like Corporates, trusts, partnership firms etc.

   Thus, before opening an account the bank has to be convinced that:

   a. The applicant mentioned in application form is same as he/she claims to be
   b. There is sufficient information regarding the occupation of the customer.

   Banks should desist from bothering the low-risk customers for want of documents and search for alternate means to solve the problem to its satisfaction. e.g., In case a customer is unable to give proof of residence, since utility bill is not in his name, then the bank can request for identity documents and utility bill of his relative with whom he stays and take a undertaking from the relative confirming that the customer is his relative and stays with him. In absence of KYC documents, other KYC compliant customer of the bank can act as introducer.

3. Ongoing Monitoring of Transactions -Banks should have a system of periodic verification and updation of information related to customers' identity. The transactions taking place in the account should also be monitored to track those which are suspicious in nature. The risk category may be modified based on new set of information.

**Customer Identification (KYC) for Non-Individuals**

KYC is necessary not only for individual customers but also in case of Legal Entity/Non Individual. For opening an account in such cases, the banks should ensure the following:

I. Legal status of the entity is established through the relevant documents issued by reliable sources e.g. certificate of registration
II. Person who represents the legal entity is duly authorized by law to represent the entity and his identity is also verified.
III. Natural Person or beneficial owner who controls the legal representative should also be identified and his or her identity should be verified.
   Accounts held by Non Legal Entities are commonly a Trust Account or Company Account or other account operated by intermediaries and KYC policy is also applicable to them. Such accounts are normally operated by intermediaries or legal representative of the beneficiary.

**Trust or Fiduciary Account**

Caution should be exercised by banks while opening an account in the name of a trust or any fiduciary account. Banks must scrutinize whether the customer is representing another person

as a trustee or as his nominee or as intermediary. In such case the banks have to do the following:

I. Peruse the documents substantiating the identity of the intermediary or office bearer
II. Peruse the documents substantiating the identity of the natural person who has appointed the intermediary or office bearer.
III. Check the operational arrangement between the intermediary/office bearer and the person appointing him.
If the entity is a trust then documents to be collected are as follows:

I. Certificate of Registration of trust
II. Trust Deed
III. Resolution empowering the intermediary or office bearer to operate the account on behalf of the trust
IV. Verify the Identity of the settlors and trustees to the trust
V. Address proof of the entity
VI. Verify the identity documents of intermediaries operating the account.

**Account of Companies and Firm**

Bank should conduct the following checks in case of company applies for opening account with the bank:

1. Examine the control structure of the entity, source of fund, business it conducts and identify the natural person who comprises the management.

2. Collect proof of name, address and business affair of the concern. There are various documents which can be used as evidence of the same like Registration certificate, Shop and Establishment License issued by Municipal Authorities where the business is located, Goods and Service tax certificate, license issued by any registering authorities like ICAI or ICWAI for Chartered and Cost Accounting firms, Medical Council of India for Medical Practitioners etc. Licenses issued by authorities of Central or State Government are also acceptable.

3. Collect the resolution authorizing the office bearers (intermediary) to operate the account

4. Collect identity and residence address proof of the office-bearer (intermediary) who will operate the account.

**Client Account Opened by Professional Intermediaries**

If the bank account opened by a professional intermediary who represents a single beneficiary client then that client's identity should be verified.

If the account is a pool account opened and managed by an intermediary on behalf of mutual fund, pension fund etc. then KYC verification would be based on whether the accounts are merged or not. When funds held by the intermediary in the bank are not consolidated and there are sub-accounts, each attributed to a beneficiary owner, then identity of each owner should be verified. If the funds are merged in one account, then bank should attempt to identify the beneficiary owner. Alternately the bank can also rely on the intermediary to complete the customer verification provided the

intermediary is also a regulated entity and has sufficient control systems in practice to conform to the KYC requirements.

**Accounts of Politically Exposed Persons Residing Abroad**

These accounts belong to individuals who hold prominent public position in a foreign nation. Banks need to collect information about the person from sources available in public domain. Banks have to identify the person and seek in depth details about the origin of funds prior to onboarding such customers. Monitoring of such accounts should continue on an on-going basis.

**Importance of KYC Compliance**

The Reserve Bank of India penalizes the banks if it falters in following the KYC guidelines. Cases of fraud or misrepresentation may occur which would jeopardize the interest of the bank and also put the general public who keep money with bank, at risk. The risk can be classified as follows:

I. Banker cannot avail statutory protection – Section 131 of the negotiable instruments act give protection to the bankers if he collects cheque or bill etc. on behalf of the customer who has no title or has a defective title provided the banker has acted in good faith and without negligence. Such protection will be withdrawn in case the bank opens an account without conducting customer due diligence because it would be construed as an act of negligence. Such customer, if he commits fraud or does an act of misappropriation of fund, the banker would not have the statutory protection.

II. Risk in case of overdraft –Proper introduction of the account holder is necessary because if he is given an overdraft facility by the banker and he fails to repay it, the bank may have to book a loss.

III. Risk in case of undischarged insolvent-Generally the account of a person who has gone insolvent is attached till the time he is absolved. If such insolvent entity opens an account without proper due diligence being done then the deposit in the account is vulnerable to the risk of attachment.

IV. Risk in case of issue of bogus cheques- If a bank issues cheque book to a customer without verifying the identity the chances are that he may issue bogus cheques without having balance in the account.

## 4.2 Secondary Functions of a Bank

As stated earlier the primary purpose of the bank is to solicit deposit and disburse loans. The primary relationship of the bank and customer is akin to relationship between debtor and creditor though with some differences. It is described in details in the subsequent paragraphs. The banker also performs secondary functions where he may act as agent of its customer, a trustee and even as a lessor in which case the relationship will change to Principal-Agent, Beneficiary-Trustee and lessor lessee respectively. Thus, the association between the banker and customer is dynamic and keeps changing for different functions which the bank performs. The secondary functions involve collecting bank draft, cheques, and bills of customer, payment of insurance premium or loan instalment of customer, purchasing or redeeming securities on behalf of customer etc.

**Forms of Relationship between Banker and Customer**

**Banker as Debtor**

When a bank accepts deposits as a part of its primary function, it becomes a debtor and the person depositing money with the bank becomes the creditor to the bank.

**Banker as an Agent**

A banker performs various functions as an agent of his customer for their convenience often by charging a fee. Such agency functions are, collecting cheques, draft, bill of exchange, dividend, interest etc. on behalf of customer and credit them to the customer's account, sells and purchases securities and makes payments of various dues of the customer e.g., insurance premium, loan instalments etc. The bandwidth of such agency function has increased over the years because banks have taken up diverse functions like payment of utility bills and resolving tax problems of the customers. Such functions are done on specific instruction from the customer.

**Banker as a Trustee**

In certain situation the banker serves as a trustee to the customer. A trustee is a person who holds money or assets and performs certain acts on behalf of another person called the beneficiary. The profit earned from the asset continues to belong to the beneficiary. The valuables kept in the bank continue to be the property of the customer while the banker acts as trustee or custodian. The valuables and assets belonging to the beneficiary are separate from general assets of the bank so that in case of insolvency of the bank the assets and valuables cannot be distributed to fulfill the claims of the general creditors. However, deposits in the account are eligible for distribution to creditors in case of insolvency. The relation of a banker as a debtor or trustee is dynamic based on the conditions in different instances. When a banker executes any activity as a part of its routine business operations without specific instruction from the customer his role is of a debtor or creditor. Examples are

1. If a person who does not have an account in the bank, deposits money with the bank with order to keep it till further instruction then the bank becomes trustee and customer, the beneficiary.
2. If the customer instructs his bank to remit a certain sum of money to another account in other bank or branch and the bank becomes insolvent before transferring the amount, the bank will remain a debtor to the customer (and not become a trustee) because the specific instruction for transfer has not been carried out.
3. When a cheque is sent to payee bank for collection of money from another banker, the collecting bank remains a trustee to the amount till the amount is deposited in the customer's account. Only after deposition in the account the banker becomes the debtor. However, if the collecting bank becomes insolvent before realization of the cheque from the paying bank, the money so realized will belong to the customer and cannot be utilized for settling the claims of general creditors.

**Banker as a Licensor**

When a customer hires a locker in the bank, the latter becomes a licensor and former acts as a licensee. The nature of association conforms to that of a landlord and tenant.

**Other Special Relation**

Bank can also have other relation with its customer e.g., Pledger Pledgee or Mortgagor Mortgagee or Bailer Bailee. When a customer promises certain movable asset or security to the bank in order to avail a loan from the bank then the customer becomes a pledger and bank becomes pledgee. When a customer promises certain immovable asset to the bank in order to avail a loan from the bank then the customer becomes a mortgagor and bank becomes mortgagee. When a customer keeps a good in safe custody of the bank for a particular purpose with the condition to get it back when the

purpose is over it is called bailment and bank becomes the bailor e. g pledge of stocks as security to avail loan

**Debtor- Creditor Relation of Banker and the Customer**

The debtor creditor relation evolves from the primary function of the bank so it has been discussed in details in subsequent paragraphs. When we look at the primary function of accepting deposits and giving loans, the nature of relationship is of debtors and creditors. When an account is opened the bank becomes the debtor. The customer, in legal parlance, lends money to the banker as a debt which the banker can use to its discretion till the creditor demands his money back. The banker is bound to repay the debt when requested by the customer.

As long as there is credit balance or positive balance in the account of the customer the banker remains the debtor. However, when there is debit balance or negative balance in the account due to overdrawing (Overdraft account), the customer becomes the debtor to the banker till the time he repays the loan to the banker.

The debtor-creditor relation between the banker and customer is different from the normal debtor creditor relation as applied to business. The differences are enumerated below:

1. Creditor must demand payment- In normal business transactions the debtor has to pay the creditor on or prior to the due date of payment or whenever demanded by the creditor. However, in case of deposit the banker need not have to pay the amount on his own account. The depositor must present the demand for payment of the deposit by following procedures defined in banking guidelines. The reason for payment against demand stems from the fact that the banker accepts the deposit with additional responsibility to honor the cheques issued by the customer. If the banker returns the money on his own by closing the account, there are chances that some cheques issued by the customer will get dishonored, tarnishing his reputation. Thus, consent of the depositor is necessary for returning the money and closing the account.

2. Proper place and time of demand- The demand for withdrawing the money has to be made by the customer by following a pre-defined process either by filling up withdrawal form and submitting it at the home branch where the account is located or by issuing cheque. The bank can also issue demand draft and travelers' cheque in which case the repayment of deposited amount can be paid at other branches of the bank.

   After implementation of Core Banking Network, the cheques issued by a customer can be encashed at any other bank branch and at any location. The demand for withdrawing cash has to be made in bank working hours only if withdrawal happens at bank branch. However, 24 hours withdrawal can be made through ATM, debit cards and electronic banking channels.

3. Demand must be made in appropriate manner- Demand for withdrawal cannot be made verbally or on telephone. It can be withdrawn through specified modes like demand draft or cheque or at ATM through card or through bank transfers by adopting procedures specified by the bank.

4. The depositor is classified as an unsecured creditor of the bank even though deposits up to Rs 500000 per depositor are insured by the Deposit Insurance and Credit Guarantee Corporation. The insurance premium is borne by the bank.

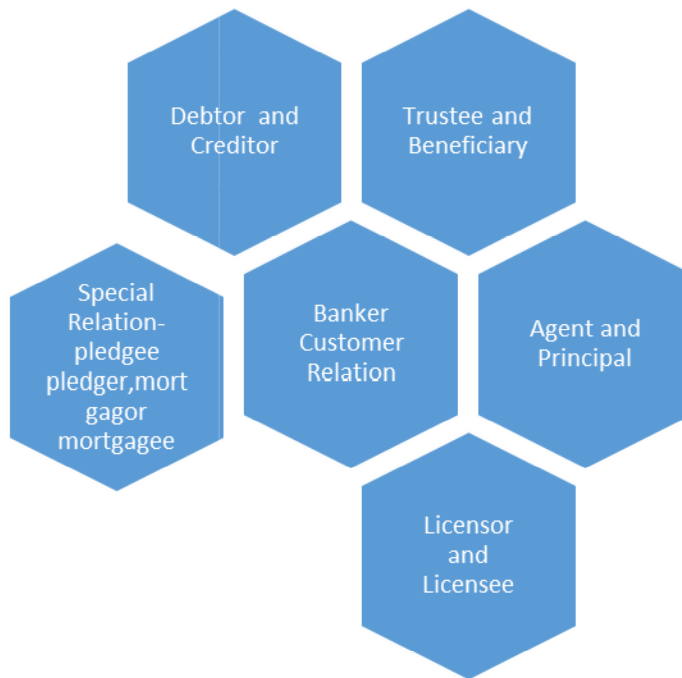



**Figure 4.3:** Various Relations between Customer and Bank | **Source:** Prepared by the Author

**Obligations of a Banker**

**Honor the Cheques issued by Customer**- The customer issues cheques for payments and the banker are obliged to honor them subject to the undermentioned conditions being fulfilled:

I. There must be adequate amount of money in the drawer's (customer) account with the drawee (bank). The account of the customer from where he has drawn the cheque should have funds not less than the amount of the cheque presented. In other words, the clear balance in the account should be equal to the amount mentioned in the cheque. Clear Balance implies that cheque sent for collection by the customer is not treated as cash in hand of the banker till the time it is realized and credited in the account. So, the customer should not issue any cheque on amount which is unrealized by banker.

II. The funds in the account must be properly applicable to the payment of the cheque. The account from which the customer has issued the cheque should not only have funds not less than or equal to the amount mentioned on the cheque but also such fund should not be assigned by the customer for specific purpose. In case part of the fund is assigned the said part will not be available for payment and cheque will get dishonored.
Similarly, if a depositor fails to keep adequate balance in his account for the banker to honor the cheque, he cannot claim that he has fixed deposit with the banker based on which cheque should be honored. The fixed deposit is a separate agreement and cannot be withdrawn through cheque.
In case banks sanctions overdraft to a customer then the banker's obligation to honor the cheque increases to the extent of the overdraft sanctioned. However, bank should inform the customer well in advance before withdrawing or reducing the overdraft facility.

III. A banker has to honor the cheques only when he is duly required to pay. The cheques should be completed in all respect bearing amount in figures and word, date, signature etc. Cheques which are presented to the bank for collection after three months from the date of issue, is treated as stale and dishonored by the bank.

IV. Maintain confidentiality of Account. The customer's account is a documentation of all his financial transactions and portrays the state of his financial position. The banker is duty bound not to divulge purposefully any facts related to his customer's account to a third party and also take necessary safeguard to confirm that no such facts get revealed inadvertently. However, the information can be divulged if required by law e.g., information sought by Income Tax authorities.

## 4.3. Agriculture Lending by Commercial Banks and Regional Rural Banks

**History of Agricultural Lending**

Prior to independence it was the co-operative banking sector which was envisaged as the vehicle for disbursement of agricultural credit throughout the country. The McLagan Committee in 1915 in its report advised the Imperial Government for establishing Co-operative banks in all the provinces of the country and by 1930 the three-tier co-operative structure was prevalent in all the provinces. However due to the mounting over dues the performance of co-operative banks remained a concern for the policymakers of the country in the pre-independence period.

The All-India Rural Credit Survey Committee (1954), set up to evaluate the performance of co-operatives, in its report acknowledged that the Co-operative Banks have failed to meet the credit needs of the farmers. It recommended that commercial banks should also contribute to the share of agricultural credit disbursement along with co-operative banks to meet the huge credit requirement of the farmers. The committee further recommended the establishment of a State Bank of India for extension of commercial credit facilities to the rural areas. Towards this end the Imperial Bank of India was transformed to State Bank of India in 1955 as Government owned commercial bank.

During the sixties the contribution of commercial banks in disseminating agricultural credit was negligible. Their loans to agriculture were confined only to financing the logistics and transport of agricultural produces. In order to fit them into the social goals, Government ordered the nationalization of fourteen commercial banks on July 19, 1969.

At the time of nationalisation, the total number of rural offices of scheduled commercial banks (SCBs) was 1,833, which increased significantly to 35206 by 1991. The credit disbursement by Commercial Banks also increased significantly after nationalisation which is evident from the figure 4.4. The commercial banks contribute for 84% of the credit flow in rural areas while the remaining is contributed by Regional Rural Banks and Co-operative Banks. Though the commercial banks were expanding rapidly in rural areas the policy makers felt that commercial banks lacked the rural familiarity and ground level experience to cater to rural poor. They felt the need for an exclusive rural focussed bank which would be a blend of the professional character of commercial banks and the grass root level acumen of the informal lenders. With this objective the Regional Rural Bank Act, 1976 was promulgated with a view to set up the Regional Rural Bank for development of agriculture,

trade, commerce, industry and other productive activities in rural areas for the benefit of small and marginal farmers, artisans and rural entrepreneurs.

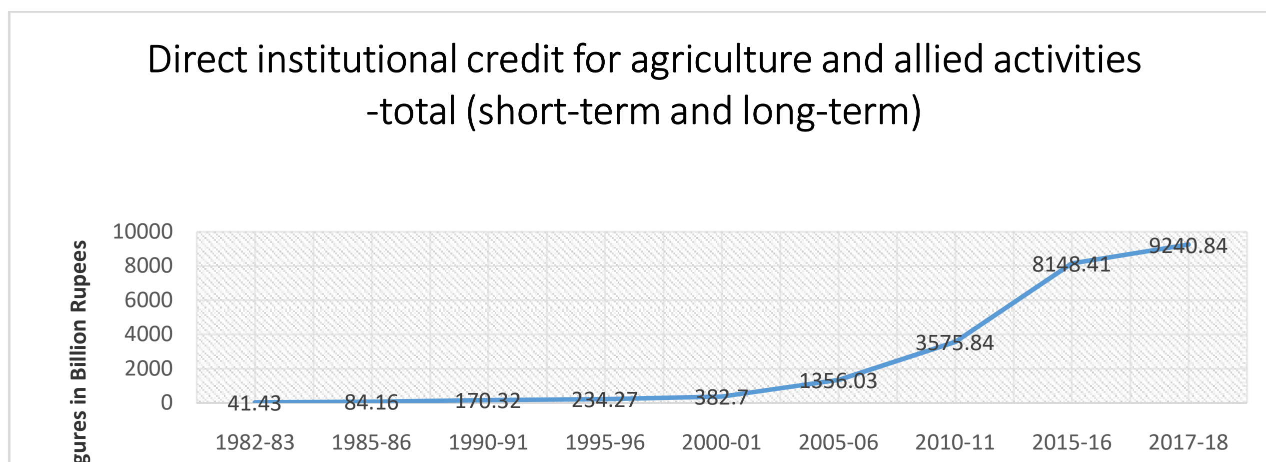



**Figure 4.4** Terminology Associated with bill of exchange **| Source:** NABARD Annual Report

**Establishment of Regional Rural Banks**

On July 1, 1975 a working group on rural banking was appointed under the Chairmanship of Shri M. Narasimham. The group suggested that a State Sponsored, region specific, low-cost structure banks be set up to specifically focus on banking in rural areas. The committee observed that such banks would display a blend of the rural touch of co-operative banks and professional management of the commercial banks. By establishing such banks, the rural savings can be effectively utilized for rural lending.

The Government accepted the recommendation of the working group and RRB ordinance was promulgated on September 26, 1975. The ordinance became an act on February 9, 1976. The regional rural bank were established with shareholding participation of Central Government (50%), State Government (25%) and sponsoring public sector bank (25%).

**Objectives of Regional Rural Banks**

I. Mobilize savings from rural people and promote saving habit
II. Provide credit support to rural population who are economically weak
III. Rein the usurious rate charged by moneylenders
IV. Increase banking outreach to unbanked rural areas including economically backward tribal areas.
V. Augment the effort of Commercial Banks and Co-operative Banks delivering credit in rural areas.
VI. Overall development of rural economy.

**Characteristic Features of Regional Rural Bank**

I. Specific area of operation- Every rural bank has a specified area of operation which has been notified by the Central Government. Its head office has to be located in the notified operational area only.
II. Capital – The authorized share capital of the bank was revised to Rs 2000 crore divided into 200 crores of fully paid share of Rs 10 each by RRB Amendment Act (2015). As per the initial Act it was Rs 5 crore share capital was split into 5 lakh shares each valued at Rs 100. Half of

the share capital is contributed by the Central Government and remaining by the state government and sponsor bank in ratio of 15: 35. The amended act also allowed the RRBs to raise share capital from external sources excluding the Central Government, State Government and Sponsor banks. However, for raising external capital that the combined share of Central Government and the sponsor bank should not fall below 51 percent. If the share contribution of the state Government reduces to less than 15 percent of the paid-up capital on account of raising share capital from external sources then prior consultation between the State Government and the Central Government is mandatory.

III. Scope of Business – During initial years 70s and 80s, the scope of business was restricted to accepting deposits and lending to agriculturist and weaker section of the society. Subsequently in nineties the scope of business was increased gradually and at present the RRBs do all the business which a commercial bank undertakes except the forex business, which they can do but to a very limited extent.

IV. Staff of RRBs- The staff requirement is decided by the Board of director as per the policy guidelines prescribed by Central Government. The staff is recruited with the assistance of Institute of Banking Personnel Selection. Staff is often deputed from the sponsor bank if required.

V. Establishment- For establishing a Regional Rural Bank there is a primary need for a sponsor bank. The sponsor bank may be a bank either in public sector or private sector and permission is required from the Central Government. Thereafter a notification is published in the Gazette containing the name of the new RRB and the name of the state or district within which it would operate.

The Regional Rural Banks became one of the vehicles for agriculture lending along with Commercial Banks and Co-operative Banks. This was known as multi agency approach to agriculture lending.

**Performance by Regional Rural Banks**

The Gross NPAs of RRBs were rising over the years and by late eighties it reached a level were the bank needed recapitalization to continue operation. In 1991 Government of India decided on banking sector reforms as a part of economic liberalization. RBI Introduced the rules for classification of assets and recognition of income for RRBs to instil financial discipline and transparent reporting. The lending rates for these institutions were deregulated to usher competition. The RRBs were permitted to finance the non-target group and promote non fund business to increase revenues. They were permitted to open Non-Resident rupee account. They were also allowed to provide loans for housing and education and loan against gold and other non-priority loans.

Between 1994 and 2005 many committees were appointed to suggest remedies to make the RBs profitable and sustainable. Government deliberated on various measures recommended by these committees from time to time like merger of RRBs with sponsor banks, creation of National Rural Bank of India, horizontal merger amongst RRBs functioning in adjacent areas, change in sponsor banks, liquidation of RRBs etc. but finally it decided on recapitalization and consolidation of the RRBs based on the fact that these banks are deeply spread in rural areas and have played a very crucial in not only in last mile credit delivery but also in mobilizing rural deposits ( Figure 4.5)

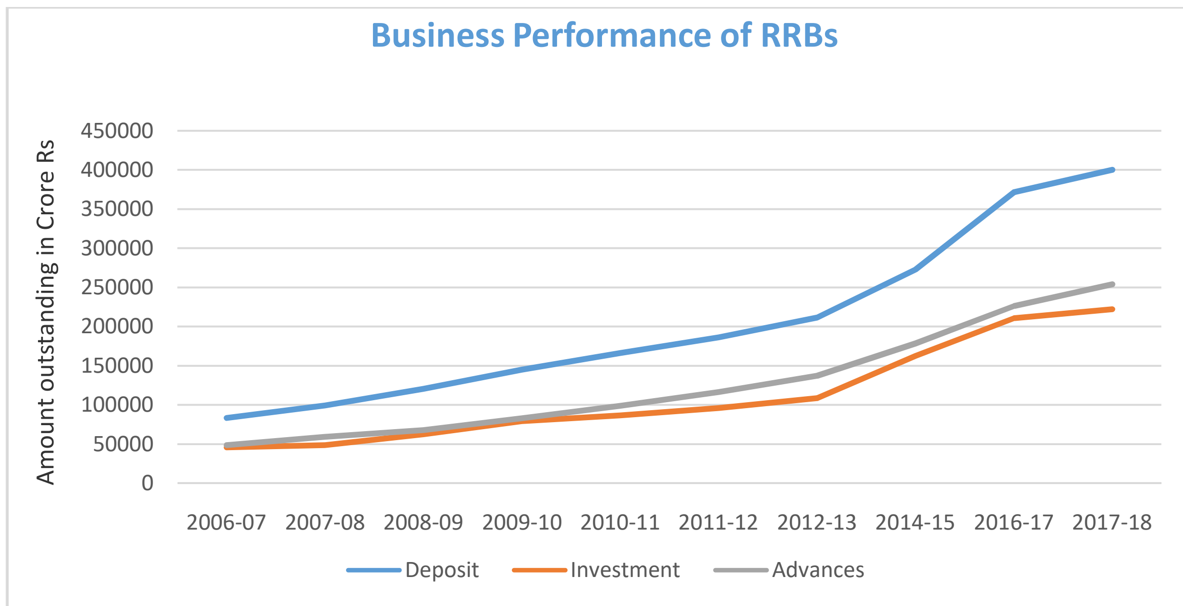



**Figure 4.5:** Business Performance of RRBs | **Source:** NABARD Annual Report

The process of consolidation started from 2005 onwards as a result of which the number of RRBs reduced drastically from 196 in 2005 to only 56 as on April 1, 2018. Further consolidation is in process. Rs 235 crores were allocated in the union budget of financial year 2019-20, for recapitalization of RRBs in order to empower them to fulfil regulatory conditions.

In Financial Year 2017-18, 11 out of 56 RRBs incurred losses amounting to Rs 1005 Crores. The number of RRBs incurring losses and the amount of losses, both have increased in recent years.

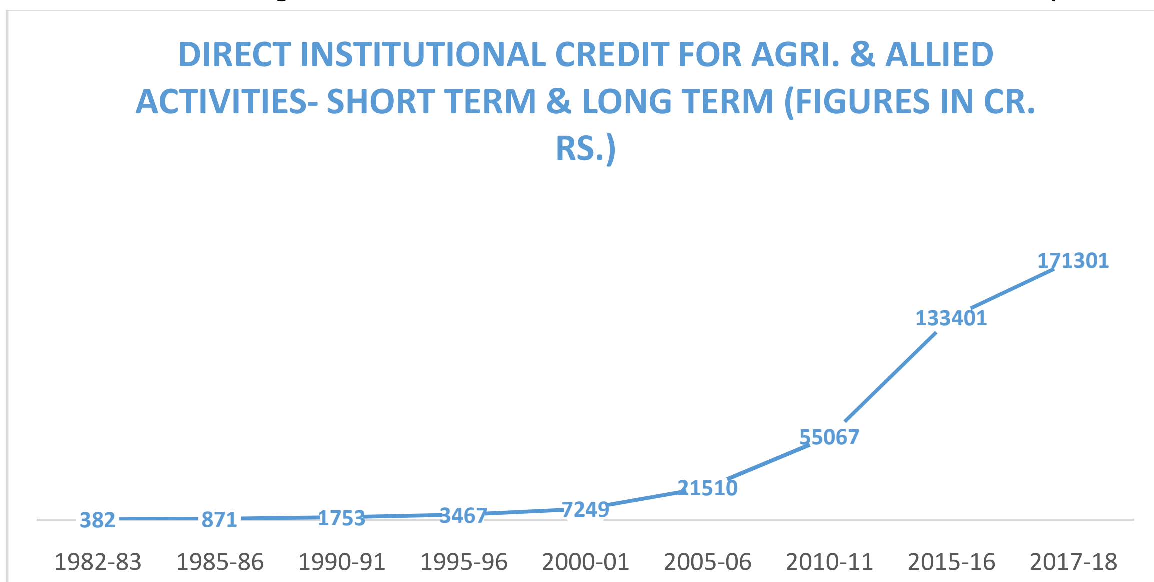



Figure 4.6: Direct institutional credit for agri. & allied activities- short term & long term | Source: Agriculture Statistics at a Glance 2018

**Limitations of Regional Rural**

Apart from the common challenges faced by all banks in dispensing agriculture credit, the Regional Rural Banks have additional challenges to face because of their small size, limited geographical area of operation, limited product to sell, low business margin and high operation cost and falling

recovery rates. Various committees were set up to analyse the reason for deterioration in performance of RRBs and some of the prominent reasons identified were as follows:

I. Limited area of operation resulted in restricted business opportunities
II. Target group were rural poor like farmers, artisans etc. who fell in high-risk category.
III. Increase in cost of operation – Initially the RRBs were envisaged to operate as a low-cost entity but the RRB employee's union approached the tribunal with demand for bringing the wages at par with the commercial banks. They won the case and their salaries increased leading to quantum jump in operational costs.
IV. Lack of guidance and Step motherly treatment by the sponsor banks.
V. Very limited basket of products to offer to the customers-only deposits and loans
VI. Dependence on Government subsidy schemes subdued their effort to generate business from market;
VII. Poor understanding of customer behavior, sloppy credit appraisal leading to increase in impaired assets.
VIII. Unionized staff with little commitment to business and profit generation.
IX. Dependency of Board on sponsor banks, NABARD, Government of India and RBI for most of the decision making.
X. The combined effect of these factors led to most RRBs eroding their capital base and in some cases the depositors' fund.

**Contribution of Commercial Banks and Regional Rural Banks in Agriculture Credit**

Agriculture sector contributes to food security of the country and major source of employment. Nearly 55 percent of the total workers are employed in Agriculture and Allied sectors. Though the contribution of agriculture sector to Gross Value addition has declined over the years but that does not reduce the importance of this sector. The sector has grown over the years with various revolutions happening like green revolution which increased the food grains production, white revolution for milk production and blue revolution which focussed on increasing fisheries production. The sector has not only become self-reliant but has emerged as exporter of agricultural commodities like rice, marine products etc. All these developments speaks of the Government resolve to make the country self-sufficient in agriculture and allied sector.

Such rapid growth would not have been possible without adequate credit intervention by the banks. The Commercial Banks, Regional Rural Banks and Co-operative banks are the three channels for distribution of agricultural credit, among which the first two together share nearly 87 percent of total credit outstanding. We will confine our discussion to the contribution of Commercial Banks and Regional Rural Banks which have the maximum share of outstanding agricultural credit.

The financial institutions have set a widespread footprint in rural India through widespread network of branches and outlets. It is no exaggeration to say that the diffusion of Green Revolution was greatly facilitated by the formal credit system providing large amounts of investment and production credit to farmers. The success of white revolution, development of horticulture, poultry, fishery and oilseed has been facilitated by institutional credit. In the year 2019-20 the total credit flow to agriculture sector reached Rs 13.68 lakh crores a growth of 8.8% over Rs 12.57 lakh crores achieved in 2018-19.

**Challenges to Credit Flow to Agriculture & Allied Sector**

The rising NPAs are the biggest challenge to the credit flow to the agriculture and allied sectors. When interest on loan or principal or both is not paid for more than 90 days then that loan is classified as Non- Performing Asset. The bank has to set aside a part of its profit in anticipation of bad loans which leads to decline in the performance of the bank. The Gross NPAs of scheduled commercial banks including RRBs have been rising over the years which is alarming as seen in Figure 4.7. The asset quality of the agriculture sector has deteriorated as the Gross Non-Performing Assets have increased. One reason for the steep increase in Gross NPAs in 2018-19 is the farm loan waiver by some states. Frequent loan waivers encourage the farmers to withhold repayment in anticipation of a waiver announcement by the Government.

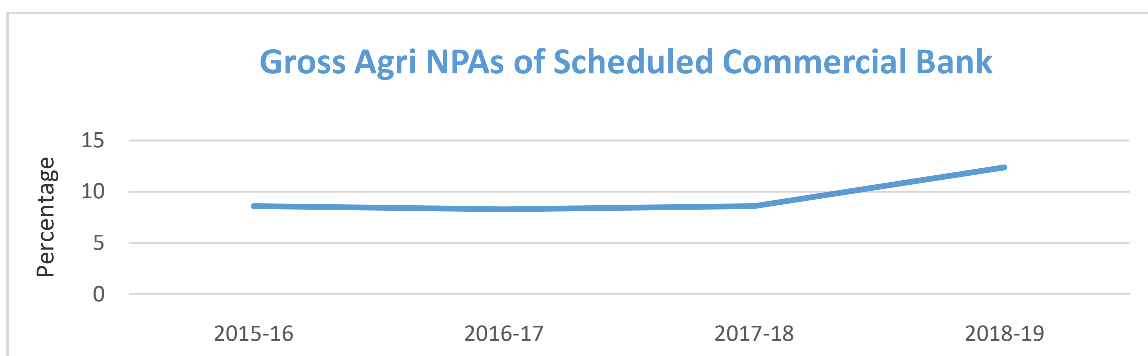



**Figure 4.7:** Gross Agriculture NPAs of Scheduled Commercial Bank | **Source:** NABARD Annual Report

Regional disparity has been observed in distribution of agricultural credit. Some states get much higher share of the agricultural credit even up to 10 percent compared to other states which get as little as 0.5 percent only. For many states the share of agriculture credit is much less compared to the agricultural output.

As per the NAFIS report 2016-17, 72 percent of loan taken by rural household were met through institutional sources and 28 percent from Non- Institutional sources. So a significant portion of rural households still depend on non-institutional credit, normally at usurious rates. As per the PSL annual return (2015-16) only 41 percent of the small and marginal farmers were covered by the private and public sector banks.

Banks provide crop loans to farmer at 7 percent which reduces to 4% in case of timely repayment. This rate is well below the informal lending rate which gives an opportunity for interest arbitrage. Farmers are either becoming moneylenders, or they are diverting the loan for operating non-farm enterprises.

**Way Forward**

In the long run Government has to provide an enabling ecosystem for widening and deepening the credit reach by digitisation of land records, reform the land lease framework and develop innovative digital solution to plug the information gap between the bank and the farmers. If banks gain online access to land record, they can check the area of the land and its ownership and if required mark a lien on the land record. Since these are primarily state subjects, a consensus has to be built between the Central Government and States.

Government started the project for digitisation of land records in 1998-99. The progress has been very slow. Again, in August 2008 the Digital India Land Record Modernisation Programme was launched by the Government of India with aim to reduce the incidence of land disputes and make the land ownership records more transparent. Majority of the states like West Bengal, Odisha, Gujarat, Himachal Pradesh, Andhra Pradesh, Tamilnadu, Jharkhand, Karnataka, Rajasthan, Chhattisgarh, Madhya Pradesh, Uttar Pradesh, Sikkim have completed 90 percent or more computerisation of land records. There are other states like the North Eastern states, Bihar, Assam, Kerala, Jammu & Kashmir which have to act fast. If land records are accessible by banks then the instances of multiple financing on same piece of land may get controlled.

In most states leasing of agriculture land in not allowed by law so the tenants do not have the security of land tenor and hence it is difficult for them to access agricultural credit. Niti Aayog has designed the Model Land Leasing Act and proposed the states to adopt the same. Andhra Pradesh Land Licensed Cultivators' Act, 2011 is another act which the states can count for guidance. Once the act is passed and the cultivator gets tenancy right, then he will be willing to invest on development of the land and he will be eligible for loans and crop insurance.

Digital innovation is another area which, if developed, can give accurate information about the prospective borrower and banks can conduct better credit risk appraisal in less time. Geo Tagging and Remote Sensing can help in getting information about crop sown, acreage under different crops, yield estimation, assessment of crop progress and crop damage, mapping of farm resources like irrigation facility, soil quality etc. A unified national agriculture market can be created by linking all the agriculture market yards so that the farmers are able to discover the best price and can sell their produce in any market of their choice. Banks must search for technology driven solutions for ease of credit delivery to the farmers for agriculture and allied activities.

## 4.4. Medium Term lending by Public Sector Banks

Loan provided for more than 18 months are classified as term loan which are further classified in two parts:

1. Medium Term Loan – These are loans which are repayable within 2years to 5 years or maximum up to 7 years generally for purchasing agricultural machinery, tractor, livestock etc.
2. Long Term loan –The tenor of these loans ranges from 7 years to 15 years for investments like construction of tube wells, dug wells etc.

These term loans are given for purposes or projects which need substantial capital, to be invested for long and have a long gestation period for giving return so there is more risk involved and more surveillance and record keeping is required from lender's side.

**Common Terms and Conditions for Term Loans**

**1. Investment Outlay-** This refers to the initial investments needed for commencing a given project. It depends on a host of factors like the technology adopted, capacity or scale of operation planned and nature of operation. The investment outlay is submitted by the prospective borrower and checked by the bank for its accuracy.

The Investment outlay can be further broken up into:

(1) Preoperative expenses-like preparation of feasibility report, project planning, getting project approval etc.
(2) Land Development expenses- like completing boundary, levelling, connecting to water source etc.
(3) Civil Construction expenses– Civil work to be carried out for the project like building construction
(4) Equipment and Machinery expenses- Equipment and machinery to be purchased for the project.
(5) Working Capital Requirement- The capital required during the initial period when there is no income generation. This represents the operative expenses incurred during the project phase when revenue generation have not started e.g., labour wages.

Bank checks the investment outlay to ensure that the costs are not inflated with the intention to secure higher loan amount.

2. **Margin Money-** The bank finances only a portion of the investment outlay, remaining is contributed by the borrower. It represents the stake of the borrower in the total cost. Margin money represents the share of the borrower in the project. Bank should confirm the availability of margin money because the project does not get stalled if the farmer is unable to contribute margin money.

3. **Bank Loan**- The bank loan depends on the total investment outlay less margin money of the borrower. The bank loan should be adequate to meet the cost of the project and it should be provided on time. The repayment capacity of the borrower needs to be verified also.

**Classification of Agricultural term loans**

1. **Area Development Schemes**- They aim at developing an area with regard to a particular activity. For example, if a bank formulates a scheme for dairy development in a district it will be an area development scheme. The investment and Outlay will usually be uniform for all such units and large number of such units are planned e.g. Bank may provide loan of Rs 25000 to each borrower for two buffaloes and 100 such units can be financed.
2. **Banking Plan** – These are similar to Area Development Scheme which is prepared by development agencies like State Government or NABARD. Such schemes may operate in large area like a state or even two or more states. Since the area of coverage is high and many units are involved, more than one bank are involved in the project.
3. **Individual Borrower Oriented Investment-**In this case individual borrower approaches the bank for term loan after preparing a project plan and outlay.

**Repayment Period and Schedule**

Repayment schedule represent the number of instalments, amount of instalments, frequency and period of repayment.

Principle of fixing repayment schedule –Repayment schedule is generated based on the assessment of repayment capacity of the borrower, which depends on the expected surplus from the activity, sustenance requirement and the life of the asset that is required. The Banker would have to estimate the cash flow of the farmer from the additional asset and the surplus from which he would

make the repayment. NABARD has suggested the following guidelines to the banks for fixing the instalment amount:

I. In case of small and marginal farmers-50 percent of the incremental income. Incremental income refers to the additional income that would be generated after starting the project or activity.
II. In case of other farmers- 75 percent of incremental income

The bank should ensure that sufficient surplus is left for household consumption after paying the instalment. The repayment period is fixed for different activities based on the cost of acquiring the asset, life of the asset financed and surplus generated.

Grace Period- Some investments do not provide immediate return and have long gestation period so recovery of the loan cannot be expected during the period e.g., investment in forest plantation, horticulture, poultry etc. The grace period suggested by NABARD for agricultural term loan is:

1. 11 months for sprinkler/drip irrigation
2. 12 months for poultry
3. 6-7 years for horticultural crop e.g., mango, cashew etc.
4. Cows/Buffaloes grace period is linked to lactation period

Type of Repayment Schedule-Different bank adopt different method for calculating the loan instalment based on their lending policy.

i) Equal Instalments- The principal amount is divided by the tenor in number of months and interest is recovered separately. This method is simple to calculate but since the interest is higher in the initial period the burden on the borrower is more.
ii) Equated Instalments –The same amount is repaid every month and it includes the Principal and Interest Component. This system is better for recovery from people who have regular source of income. The Principal component increases and interest component reduces with the progress of tenure.

Equated Instalment=Loan amount X CRF[4]

CRF = $r\,[(1+r)^n] / [(1+r)^n-1]$ where r-rate of interest , n- tenor

CRF or Capital Recovery Factor at 15% for 5 years is 0.2983 for annual repayment. CRF may be multiplied by loan amount to get the equated instalment.

iii) Graded Instalment – In case the project generates more surplus with passage of time like horticultural crop or it generates less surplus with passage of time like machinery (maintenance cost increases with time) the instalment has to be adjusted to the fluctuation in surplus across the tenor. In this case the graded instalment is suitable. When the surplus is gradually rising the instalment can be fixed in a gradually increasing order or vice versa. This system is not common in our country.

iv) Security Requirement- To make sure that loans are repaid on time, the bank keeps some tangible asset of borrower as security which can be sold in case of default. However since small and marginal farmers cannot provide such conventional security so the RBI has devised certain security norms for PSL which include term loans also.

[4] Capital Recovery Factor

**Major Issues in Financing Term Loans**

I. Bankers often lack the ability to conduct risk analysis of bigger term loans.
II. Term loans are often exposed to risk due to natural calamities which can neither be predicted nor fully covered.
III. Interest rate are not based on transaction cost and risk cost. It is rather linked to base rate of the bank in case of agricultural term loan.
IV. There are large number of accounts with long repayment period which makes monitoring difficult.

## 4.5. Legal and Regulatory Framework

**Overview of the Negotiable Instrument Act, 1881**

A negotiable instrument is a document which is signed by the maker, where he promises a specified amount for payment to a specific person or to his assignee. One of the characteristics of negotiable instrument is that it can be assigned by the payee to another person who then receives the money. Once the instrument is assigned, the assignee acquires the complete legal title to the instrument.

Transactions through use of Negotiable Instruments are governed by the Negotiable Instruments Act. The act came into effect from 1st March 1882. However, sections 138 to 142 were added later with effect from 01-04-1989 and amended again in 2001. The act has 17 chapters and 147 sections.

What is the various types of negotiable instrument?

A Negotiable Instrument can either be in the form of a Promissory Note or Bill of Exchange or cheque payable either to order or to bearer.

What is a Promissory Note?

A promissory note is a signed instrument issued in written form carrying an unequivocal commitment by the maker, to pay the stated amount of money only to a specified person or to the bearer on a certain date or on demand. Certificate of deposit, Commercial paper and treasury bills are categorized as promissory note.

What is a Bill of Exchange?

A bill of exchange is a written order to a person directing him to pay a specified sum of money to the signatory or to the named payee. Bank draft is a bill of exchange. Maker of the Bill of Exchange is the payee and acceptor of the bill of exchange is the payer.

What is a Cheque?

A cheque is a form of bill of exchange drawn upon a specified banker and payable on demand. The drawer of cheque instructs a bank to pay a specific amount of a specific currency from a specified bank account held in the drawer's name with that institution. The amount has to be paid by the bank of the person issuing the cheque after it receives the cheque mentioning the exact amount, date, name of the beneficiary and signature. Share and dividend warrant are classified as cheque.

The similarities and differences of various negotiable instruments are mentioned in table 4.2 below

**Table 4.2:** Characteristic Features of Different Negotiable Instruments

| Promissory Note | Bill of Exchange | Cheque |
|---|---|---|
| Issued in written form | Issued in written form | Issued in written form |
| Maker/Promisor/Payer has to authorise the document by signing | Maker/Payee has to authorise the document by signing. | Drawer has to authorise the document by signing |
| Contains unconditional promise to pay | Contains unconditional order to receive | Contains unconditional order to pay |
| Amount of money is specified | Amount of money is specified | Amount of money is specified |
| Amount is paid to a specified person or to the order of a specified person or to the bearer of Promissory Note | Amount is paid to a specified person or to the order of a specified person or to the bearer of Bill of Exchange | Amount is paid to certain person or to the bearer of the cheque |
| Either Payable on Demand (Demand Promissory Note) or Payable after a certain definite period of time (UPN) | Either Payable on Demand (Sight Bill) or Payable after a certain definite period of time ( Usance Bill ) | Always Payable on Demand drawn on specified bankers only. |
| Need to be stamped i.e. stamp duty is payable | Need to be stamped i.e. stamp duty is payable | Need not be stamped |
| RBI Act prohibits payable on demand to a bearer. | RBI Act prohibits Bill of Exchange payable on demand to a bearer. | Must be dated and presented for payment after date only. |

**Common Characteristics of Negotiable Instruments**

The following are the common features of negotiable instruments.

I. Negotiability- The negotiable instruments are freely transferable. In case the amount has to be paid to the bearer transfer can happen through delivery. In case the amount has to be paid to order then endorsement and delivery is required. The maker/payer, drawer, payee/endorsee can negotiate.

II. Issued in Writing with Signature

III. Pay Certain Sum of Money

IV. A holder in due course gets a better title than the person from whom he acquires the title

V. It is not necessary to inform the party liable to pay if the instrument is being transferred.

VI. It is presumed that there is consideration i.e. for value received.

**Parties to a Negotiable instrument**

The parties to a negotiable instrument are given in table 4.3 below:

**Table 4.3 Parties to Various Negotiable Instruments**

| Promissory Note | Bill of Exchange | Cheque |
|---|---|---|
| Maker | Drawer | Drawer |
| Payee | Drawee | Drawee Bank |
| | Payee | Payee |

**Parties of Bill of Exchange**

I. Drawer – The person who issues the bill of exchange is the drawer. He signs the bill. He is the creditor who is entitled to receive money from the debtor.

II. Drawee- The drawee is the individual on whom the order for payment is issued by the drawer. He accepts the bill of exchange and pays money to the drawer. Hence drawee is also known as the acceptor. The drawer sends bill of exchange to the drawee or acceptor on the due date requesting for payment.

III. Payee –The person who receives the payment is the payee. He may the drawer himself or a third party.

**Parties to a Promissory Note**

I. Maker- The person who makes the promise to pay and signs the promissory note is the maker.

II. Payee –The person who is entitled to receive the payment from the maker is the payee.

**Types of Negotiable Instrument**

I. Ambiguous Instrument- An ambiguous instrument is one which may be either a bill or note for its holder. This happens because of the defect in writing the document which leads to wrong interpretation. The holder can treat it either as a bill of exchange or a promissory note.

II. Bearer Instruments -A bearer instrument, is one in which the name of the payee is not mentioned on the instrument. The ownership is transferred through delivery. The person possessing the instrument is empowered to receive the coupon payments.

III. Order Instruments- An order instrument is one that is payable to a specified payee, or to any other person designated by the payee. An order instrument is transferable by endorsement and delivery.

IV. Inland/Foreign Instrument- An inland instrument is one which is: i) prepared/drawn in India ii) payable in India/Payable or drawn on a person residing in India.

V. A foreign instrument is one which is: i) drawn in a foreign country but may be payable within or outside India. ii) They may even originate in India but only for payment to a person who resides abroad.

VI. Sight Bill/ Usance Bill – a) In case of Sight Bill of Exchange, the drawee is obliged to pay when the drawer demands and hence it is also called demand Bill of Exchange. (b) Usance bill of exchange or Time Bill of Exchange are those where payment is to be made by the drawee only on the date of maturity which is mentioned on the instrument. Similar difference exists between a demand promissory note and Usance Promissory Note

VII. Accommodation Bill and trade bill – In accommodation bill the Accommodation party stands as guarantor and has the obligation to pay if the acceptor fails to pay at the time of maturity.

Such bills are meant to provide fund to the parties of the bill without consideration. Trade bill arises due to obligation resulting from a trade transaction, like purchase of good or taking a loan.

VIII. Escrow Bill – It is a bill drawn conditionally and there is no liability to pay till the conditions agreed upon are fulfilled.

IX. Hundi- Hundis are informal system of remittance of money which is not under the ambit of normal banking channels and hence considered illegal. Those involved in such transactions may be punished by law.

Figure 4.4 lists the terms associated with Bill of Exchange

**Table 4.4:** Terminology Associated with bill of exchange

| Terms | Meaning |
|---|---|
| Term of Bill or Period of Bill | It is the time gap from the date when the bill is drawn and the date on which it matures or becomes due. |
| Due Date | It is the date when the bill becomes payable. |
| Days of Grace | The period of payment of a bill may be extended by three extra days which is called the days of grace. |
| Maturity Date | It is the date after including the three days of grace to the due date |
| Bill Discounting | It means encashment of bill before the date of its maturity. |
| | The bank deducts its charges from the bill. |
| Bill Endorsement | Endorsement means the transfer of title of the bill or promissory note to a third person instead of the drawer or the payee towards settlement of debts and dues of the drawer/ payee |
| Bill Sent for Collection | The payee presents the bill to his bank for collection of payment from the acceptor.<br>Bank presents the bill to the acceptor's bank on its due date for collection and recovers the money. |
| Dishonour of Bill | When the acceptor fails to make payment on the bill due date then it is termed as 'Dishonour of Bill'.<br>Reason for Non-payment may be attributed either to not having maintaining sufficient balance in account or insolvency. |
| Noting of a Bill | When a bill gets dishonoured it is presented to the notary public who makes a memorandum on the bill. This is termed as 'Noting of a bill'. Notary public warns the drawee to clear the dues within specified time period. |
| Noting Charges | It is the fee which the Notary Public charges for noting of dishonour of a bill. |

**Overview of the Banking Regulation Act**

The Banking Regulation Act, 1949 embodies the rules and regulation that are applicable to all banking firms operating in India. It was initially known as the Banking Companies Act 1949, which became functional from 16 March 1949. Later it was rechristened as Banking regulation Act 1949 on 1st March 1966. It became applicable to Jammu and Kashmir from 1956. There are total 56 sections in this act. In 1965 the 56th section was introduced to include the co-operative banks. The act is meant to check and regulate the random opening of bank branches and changing the location of existing branches and ensuring balance development of the Banking sector.

**Prominent Provisions of the Banking Regulation Act**

**1. Prohibition of Trading (Section 8)**

This section of the Banking Regulation Act, debars a firm involved in banking from purchase or sale or bartering of goods either in direct or indirect manner. However it may deal in the trade transactions related to bills of exchange sent by its clients for purpose of collection or for negotiation.

**2. Non-Banking Assets (Sec. 9)**

This section states that a banking company can hold an immovable property, acquired by whatsoever means, only for its own use and that too only for a period of seven years from the date the property was acquired. The bank can, transact any such property for prompt disposal within the aforesaid period. However the period may exceed seven years by a further period not above five years with due sanction from Reserve Bank of India, if needed to protect the interest of depositors.

**3. Composition of the Board (Sec.10)**

This section highlights that 51% or more of the total board members of a banking company shall consist of people with specialized knowledge or practical understanding in the undermentioned subject areas:

(a) Banking; (b) Agriculture and Rural Economy; (c) Accountancy; (d) Small Scale Industry; (e) Economics; (f) Finance; (g) Law; (h) Cooperation.

The Section further elaborates that not less than two directors should have specialization or practical understanding related to the field of agriculture and rural economy and cooperatives.

The section also states that the tenure of Chairman and Managing Director cannot be more than five years at a time.

**4. Minimum Capital and Reserves (Sec. 11):**

This section of the Banking Regulation Act, 1949, highlights the minimum paid up capital and reserves required by a banking company to start or continue the banking business in India

**(a) Foreign Banking Companies:**

If the banking company has foreign registration, it has to ensure that, its paid-up capital and reserve should be at least Rs. 15 lakhs or more. If the bank has branches in Mumbai or Kolkata or in both, from where it carries out its business, then the paid up capital and reserves should be Rs. 20 lakhs or more. Further, such banks must keep, (i) the amount of paid up capital and reserve mentioned above , and (ii) an amount equivalent to 20% of its profits earned during a year from Business

operations in India, with the Reserve Bank of India. The amount may be deposited either in Cash or as Government approved securities.

**(b) Indian Banking Companies**

If the bank has all its places of business confined to a single State, which does not include Mumbai or Kolkata, then paid up capital and reserves requirement should be Rs. 100000 in regard to its principal location of business and another Rs. 10,000 for each of the other offices located in same district of the principal place the business. Further Rs. 25,000 is required for each of those places of business located outside of the district but within the state. However in aggregate the amount of paid-up capital and reserves should not exceed Rs. 5 lakhs for the banking company. Banking companies which has only one place of business shall be required to have paid-up capital and reserves not more than Rs. 50,000

**5. Capital Structure (Sec. 12):**

The minimum ratio of banks authorized Capital: Subscribed Capital: Paid up Capital should be 4:2:1

**6. Payment of Commission, Brokerage etc. (Sec.13)**

Commission or brokerage, rebate or compensation paid by banks for issue of its shares should not exceed 2.5% of the paid up value per share.

**7. Floating Charges (Sec.14)**

Banks can create floating charge on its asset or any property with due concurrence from RBI that it is not inimical to the stake of depositors — Sec. 14A. Similarly, Banks cannot create any form of charge on its capital which is not paid — Sec. 14. Unpaid share capital is defined as the amount due when shares have been allotted and money has not been received.

**8. Payment of Dividend (Sec.15)**

This section states that a banking company can declare and distribute dividend on its shares only when the capital expenses incurred by it has been written off. These include various expenses like preliminary expenses, share selling commission, brokerage, incurred losses and other items of expenditure which are not backed by tangible assets.

**9. Appointment of Director (Sec.16)**

Section 16, disallows a person to be assigned the post of Director in more than one bank.

**10. Reserve Fund/Statutory Reserve (Sec.17)**

This section states that, every banking company registered in India before declaring its annual dividend must contribute an amount equivalent to 20% of its net profit to its reserve fund. However the Central Government may, waive this requirement for a certain timeframe based on the recommendation of RBI,

**11. Cash Reserve (Sec.18)**

This section states that, every Indian banking company has to hold cash in the form of a cash reserve ,an amount which should be not less than three percent of its time and demand liabilities The bank may establish such reserve by opening a current account either with State Bank of India or with

Reserve Bank of India or any other bank which is advised by the Government for this purpose. Alternately it can also park the money with itself.

**12. Restrictions on Loans and Advances (Sec.20)**

This section was incorporated by the Amendment of the Act in 1968. It prohibits a bank form:

(i) Accepting own share as security for granting loans or advances

(ii) Sanctioning loan or advance to or on behalf of

(a) Any of its directors;

(b) Any firm in which any of its directors holds substantial interest;

(c) Any company in which any of its directors wields significant stake;

(d) Any individual with whom any of its directors has forged relation as partner or guarantor.

**13. Liquidity Norms (Sec. 24):**

This Section states that banking companies must hold adequate assets in liquid form in its routine business operations in order to meet its short-term obligations. The assets may be held either in the form of cash or gold or government approved securities equivalent to at least 20 percent of its aggregate demand and time liabilities. This figure is subject to modification by RBI from time to time. This is also known as the Statutory Liquidity Ratio.

**14. Accounting and Audit (Sec.29 & 30)**

Section 29 deals with preparation of Balance Sheet and Profit and Loss Account as prescribed in third schedule Section 31. Further it also states that the Balance Sheet and Auditor's report must be prepared and report published within three months from the end of the period about which it mentions. RBI at its discretion may allow extension of the period by further three months.

Sec. 30 states that preparation of balance sheet and profit and loss account should happen based on guidelines provided in Sec. 29 and the same must be checked by a person having professional competence, who is known as auditor. The bank must seek approval from RBI before selecting, re-appointing or terminating any auditor.

## Overview of Co-operative Societies Act

A co-operative society is an independent alliance of persons who connect willingly without compulsion to accomplish their collective socio-economic and cultural necessities and desires through a mutually owned and self- governed enterprise. The basic goal of a co-operative society is to deliver goods and services to its members and support them to realize growth in income, savings and investment, productivity and purchasing power and foster egalitarian distribution of net surplus. Co-operatives function based on seven principles which are enumerated below:

1. Voluntary and Open Membership
2. Democratic Member Control
3. Members' Economic Participation
4. Autonomy and Independence
5. Education, Training and Information
6. Cooperation among Co-operatives
7. Concern for community

**Co-operative Societies Act**

The co-operative societies act was enacted in 1904 to curb the menace of money lenders who were lending money at usurious rate of interest to the poor farmers. The first Urban Co-operative Bank was listed at Kanjivaram in Madras Presidency in October 1904.

The act states that all co-operative societies have to be registered in the office of the Registrar of Co-operatives. The conditions for registration are as follows:

(1) All societies should have ten persons or more as members and their age should be more than eighteen years and,

(2) Where the reason for forming the society is associated with pooling of money for distribution among its members, such members should be— (a) residents of the same town or village or belong to nearby cluster of villages; or (b) belong to similar tribe, class, caste, or occupation.

**(3)** Societies which are registered with limited liability Act should have the word "limited" suffixed to its name e.g. Vihan Agro Producers Co-operative Society Limited.

**Rights and Liabilities of Members**

1. Member cannot to exert their rights till due payment is made.—members of a registered society cannot exert the membership rights till he has made the contribution to the society towards share capital or acquired such stakes in the society, as required by the rules or by-laws.
2. Votes of members.—(i) In case of those societies where the obligation of the members is not restricted by the value of shares they possess, each member shall exercise one vote only.
   (ii) Those co-operative societies where the obligation of the members of the society is restricted by value of shares they have, each member shall cast as many votes as enshrined in the by-laws. (iii) If a registered society contributes some part of its funds in acquiring shares of another registered co-operative society, then it may designate any one of its members as its representative, in the polls held by the other registered society.
3. Restrictions on transfer of share or interest.—(1) The transfer of the share of a member in the share capital of a registered society is governed by the rules related to maximum holding as may be stipulated by the State Government under this Act or by the bye-laws of the society. (2) For societies where the members have unlimited liability, a member can't transfer his share or his interest in the capital till — (a) he has been in possession of the share or interest for one or more than one year; and (b) the transfer is executed favouring either the society or to any other member of the society.

**Duties of Registered Societies**

1. Address of the society.—All notices and communication by the Co-operative Registrar would be sent at the address which has been duly registered.
2. Copy of Act, rules and by-laws — All registered society should maintain a copy of the Co-op Society Act as well as the rules and bye laws applicable to the society at its registered address. This would be open to scrutiny, without any charge, by any stakeholder in the society.
3. Audit.—(1)The account of every registered society shall be audited at least once annually by the Registrar or through people authorised by him (2) The audit shall cover the inspection

related to debts unpaid and due and an assessment of value of the assets and liabilities of the society. (3) During inspection, all the books of account, documents and ledgers should be kept at the disposal of the registrar or the collector or any person empowered by the Registrar to conduct the audit. The office-bearers of the society shall provide all facts and figures concerning the transactions and operation of the society as required by the person carrying out such inspection.

**Property and Funds of Registered Societies**

1. Restrictions on loans. — (1) A registered society shall disburse a loan to its members and not to any third party who is not a member. However, with the consent of the Registrar it can disburse loans to another society which is duly registered. (2) A society where the members liability is unlimited are not permitted to give advances against moveable property as security except with permission of the sub-registrar. (3) The State Government may forbid or impose restriction on giving advances by any registered society by mortgage of immoveable property.
2. Restrictions on borrowing — A society which is registered can solicit deposits and borrowings from non-members up to a certain limit subject to terms and conditions defined in the by-laws of the society.
3. Restrictions on other transactions —All transactions of a registered society with those who are non-members shall be governed by such proscriptions and limitations mentioned in rules framed by the State Government.
4. Investment of funds— A registered society is allowed to invest its funds in the following categories of instruments— (a) Savings Bank Account of a Government Owned Entity, (b) securities defined under section 20 of the Indian Trusts Act (c) in shares of other societies who are duly registered, (d) with any bank approved by the Registrar, or (e) in any other alternative manner which is authorized by the rule.
5. Funds not to be divided by way of profit.-Profits of the society may be distributed in the form of bonus or dividend among the members, only after appropriating to a reserve fund, twenty five percent of the profit earned during the year . The remaining profit after appropriation along with any accumulated profits of past years , if available , may be distributed in accordance with the terms and conditions prescribed by the rules or by-laws of the society. Distribution of profit among members is not permitted in societies where liability of members is unlimited except if the State Government gives permission for this purpose.
6. Contribution to charity—Any registered society may contribute an amount not more than 10 percent towards charity after appropriating 25 percent of the net profit in any year. However this requires the permission of the Registrar.

**Role of NABARD in Developing Rural Banking Structure**

National Bank for Agriculture and Rural Development was set up in 1982 as a new organisation with the objective of giving undivided attention, assertive guidance and sharp emphasis to problems related to delivery of rural credit and issues linked to development in rural areas. The functions of RBI which were related to agricultural credit and the refinance functions of erstwhile Agricultural Refinance and Development Corporation (ARDC) were handed over to the newly formed

organisation. The broad functions of NABARD includes refinancing the financial institutions by delivering them short term and long term finance, refinance support to rural infrastructure building institutions, preparing credit programme and planning at district level, oversee the operations of co-operative banks and regional rural banks and supporting their capacity enhancement efforts, designing innovative development schemes and implementing Government sponsored schemes.

The formation of NABARD was ratified by passing the Act 61, 1981 of Parliament. The bank is responsible for conducting research and framing policies related to agriculture credit and supervise the two credit delivery agencies operating in rural areas namely the Co-operatives and Regional Rural Bank. The functions may be broadly segregated into three broad categories-Financial, Developmental and Supervision and they together empower NABARD to be present in almost every facet of the economy of rural India. (Figure 4.8)

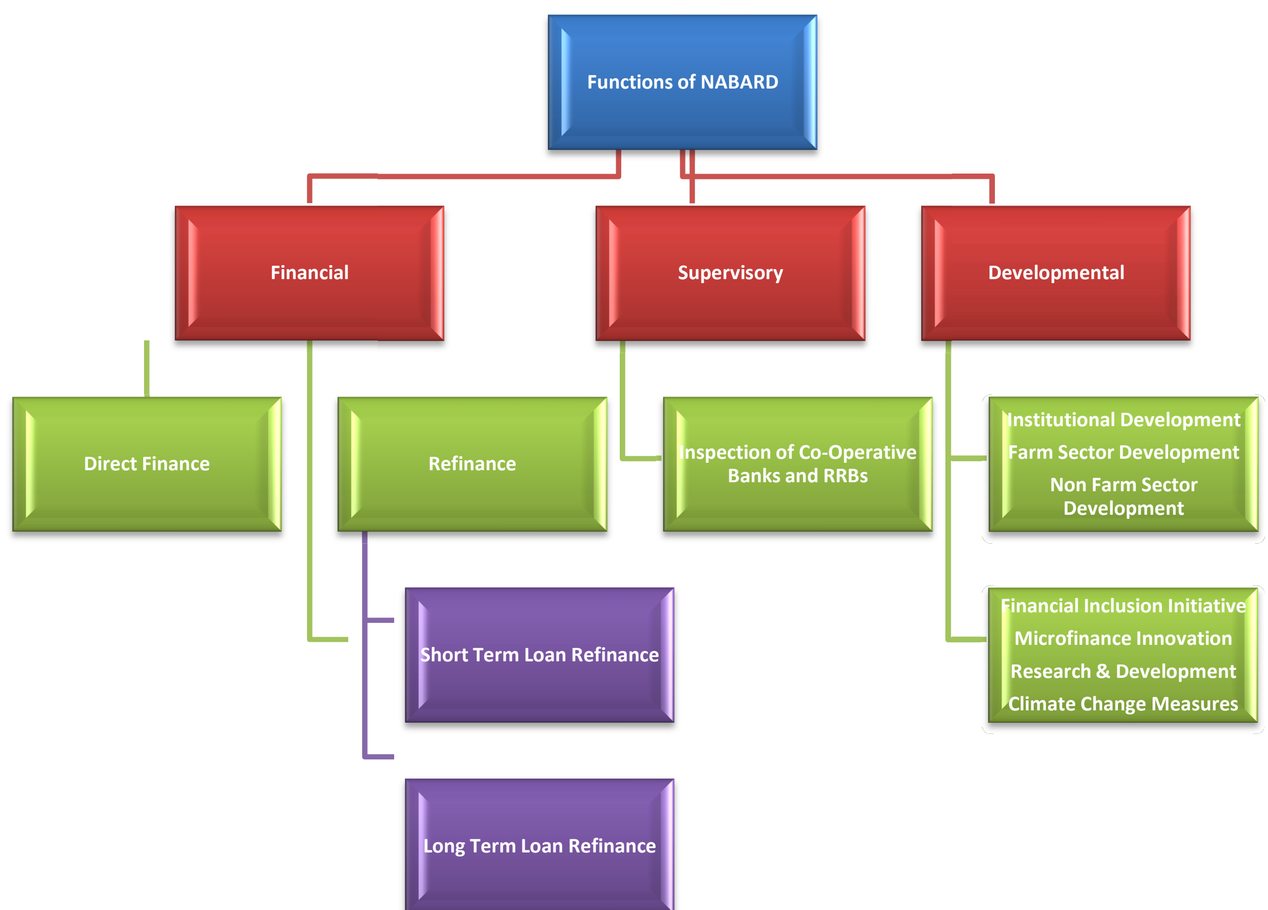



**Figure 4.8:** Broad Functions of NABARD

**Financial Function**

The financial function of NABARD may be classified as: Direct Finance and Refinance. The direct finance component includes loans to institutions involved in –building warehouses and cold chains, food parks and food processing units and marketing of agricultural commodities (Federations). Specific funds are allocated to NABARD by the Government for onward credit disbursement, based

on priorities and guidelines spelt out by the Government in the annual budget e.g. Warehouse Infrastructure Fund, Food Processing Fund etc.

Similarly there are other purpose specific funds like Rural Infrastructure Development Fund, Long Term irrigation fund, Micro Irrigation Fund, Grameen Swachh Bharat Mission, Pradhan Mantri Awas Yojana-Grameen etc. which are financed by the Government and the loan is sanctioned and disbursed through NABARD. NABARD acts as an implementing agency on behalf of the Government.

The refinance function may be further classified as : i) short term loan refinance function includes refinancing of short term loans or working capital loan to Regional Rural Banks and Co-operative Banks at concessional rate of interest. These loans are given by RRBs and Co-operative banks for agriculture and allied activities as well as for non- farm activities like artisan work, weaving etc. ii) Medium and Long Term Refinance- NABARD also provides Long Term and Medium Term Refinance to banks for providing adequate credit for helping farmers , rural artisans , rural entrepreneur to take up investment activities.

**Supervision**

The supervising function encompasses monitoring and inspection of the Regional Rural Banks and Co-operative Banks for implementing sound banking processes and on-boarding them on the Core Banking platform. It also recommends about licensing of Regional Rural banks and Co-operative Banks. It manages the talent acquisition of RRBs and Co-operative Banks through Institute of Banking Personal Selection- Common Written Exam conducted throughout the country.

**Developmental**

The developmental function involves designing new development schemes as well as implementing various Government schemes. Some of the noteworthy and successful development schemes designed by NABARD are the Kisan Credit Card Scheme and the SHG Bank linkage programme. The SHG bank linkage programme has grown into the world's largest microfinance programme.

NABARD is also involved in development of institutions delivering rural credit. Co-operatives and Regional Rural Bank cumulatively contribute to more than 50% of the rural credit portfolio. The performance monitoring of Co-operative Banks and RRBs comes under the regulation and supervision of NABARD. NABARD, in collaboration with Government of India and RBI has been implementing various measures to ameliorate the financial condition of Co-operative banks and Regional Rural Banks through continuous training and competency enhancement programmes. NABARD tracks the progress of Co-operative Banks and publishes MIS regularly to highlight their performances and suggest improvement. NABARD also attempts to bring the RRBs within the core banking network to improve efficiency of customer service.

Other than development of rural funding institutions it also supports development programmes initiated by the Government like the Tribal Development Programme, Water Shed Development Programme, Financial Inclusion, Micro-Finance Initiatives, skill development and capacity building programme etc.

**Role of Government and the Reserve Bank in Developing the Rural Banking Structure in India**

Reserve Bank of India has always been a partner in Government's endeavour towards bringing banking to the masses, especially to the rural areas of the country. Under section 54 of the RBI act the Reserve Bank of India has the authority to be involve itself in issues pertaining to rural credit and development. It can employ expert staff to provide guidance or carry out research studies for integrated rural development.

The first major effort towards step towards fulfilment of this responsibility was taken when RBI sponsored the All-India Rural Credit Survey in 1951-52. This survey studied the indebtedness in rural areas and institutional support available for meeting the debt requirement. The study observed that though cooperation has not been successful in extending the credit outreach to the weaker sections, it is imperative that it must succeed in the interest of rural development. This was the first step towards formulating a policy of extending institutional credit to the rural areas to protect the masses from the usurious rates charged by the informal sector. In the initial phase, efforts were confined towards strengthening and reinforcing cooperative credit institutions. The Reserve Bank of India, through a mechanism of refinancing the credit delivered to farm sector, has been providing financial support to the cooperative credit entities to remain viable.

The credit survey committee also advised that the erstwhile Imperial Bank of India along with its ten associate banks be converted to a single large entity, State Bank of India, with ownership of Government of India and with exclusive target to open branches in rural locations. Establishing the State Bank of India in 1955 was the first step towards diverting commercial banking system towards rural credit. It was also the beginning of the multi -agency approach towards delivery of rural credit.

In 1969, Government took a landmark decision to nationalise 14 major commercial banks to fulfil the growing need of agricultural credit resulting from the capital intensive agricultural powered by the Green Revolution. The nationalised banks supplemented the efforts of Co-operative Banks and State Bank of India in enhancing the delivery of credit to rural areas. For more focussed lending and to exclusively meet the credit needs of rural poor the Regional Rural Banks were established in 1975. They augmented the endeavour of the co-operative banks and commercial banks towards development of rural banking network.

The RBI adopted the supply driven directed credit lending policy through targeted ground level credit to fulfil the objective of social banking and inclusive financing. The priority sector lending policy came into force in 1969 .Under this policy the banks were directed to lend 40 percent of their net bank credit to designated sectors which were hitherto starved for credit. Further, out of the 40 percent priority sector lending target, 18 percent was specifically directed to agriculture and allied industries only. It further stipulated that 13.5 percent out of the sub category of 18 per cent PSL for agriculture should be in the form of direct lending to agriculture and only 4.5 percent as indirect loans.

Another land mark policy was the lead bank scheme which initiated the bottom-up approach in agriculture credit planning. In this scheme, the district became the smallest unit of agriculture credit disbursement planning and one of the banks which had the prominent presence in the district was designated as the lead bank. The lead bank was responsible to plan and co-ordinate the disbursement of agricultural credit with other banks in district so that a focussed lending approach

could be followed and the results could be monitored. This marked the initiation of regional credit planning by the RBI.

Another policy which contributed to the rapid spread of commercial banks was the one is to four branch licencing policy. According to this rule a bank which desires to open a branch in an already banked location has to open four branches in unbanked location to get the branch opening licence. The policy continued till 1990. This policy was the prime contributor to the spread of rural bank branches during seventies and eighties.

There are banks which fail to meet the annual PSL targets and sub target. In such cases the bank could compensate by contributing to Rural Infrastructure Development Fund managed (RIDF) by NABARD. Support from RIDF is provided to State Governments and state owned entities to enable them to execute infrastructure projects in rural areas. The banks which are unable to meet the PSL target in any category can also purchase a Priority Sector Lending Certificate from another bank which has over achieved its PSL target in that category.

In 1982, NABARD was established as an apex bank responsible for rural credit planning and regulating and supervising the institutions involved in the delivery of credit in rural areas. NABARD took over the Agricultural Credit functions of the RBI. It reinforced the Government's conviction towards development of the rural sector.

In 1989, RBI initiated an improved version of lead bank scheme which was known as service area approach .Under SAA plan each branch of a commercial bank or regional rural bank located in rural area is allotted approximately 20-25 villages for all around development. The designated branch would fulfil the financial intermediation need of the villages located its service area and build up linkage in bank credit and production to enhance the income levels.

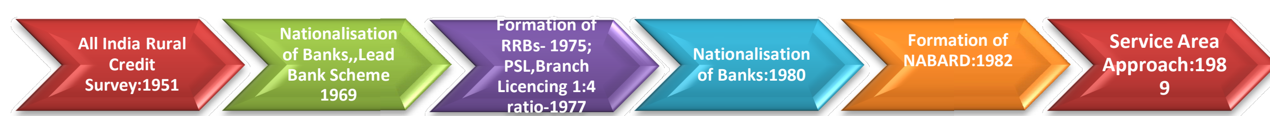



**Figure.4.9:** Initiatives towards Rural Intervention by Government and RBI -Pre- Economic Reforms

**Initiatives towards Rural Intervention by Government and RBI Prior to Economic Reforms**

In 1991 Government initiated the financial sector reforms, as a part of the overall economic reforms. The reform focussed on making the credit institution financially strong, efficient and sustainable units. RBI Introduced the rules for classification of assets and recognition of income for RRBs and cooperative banks to instil financial discipline and transparent reporting. The lending rates for these institutions were deregulated to usher competition. Private sector banks were given licence to operate. Other measures included permitting the RRBs to finance the non-target group, promoting

non fund business to increase revenues, allowing NABARD to disburse funds directly to State Co-operative Banks and Central Co-operative Banks and freeing up the investment policies for the banks.

To strengthen the institutional mechanism for rural development, in 1996-97, the idea of having Local Area Banks as a financial intermediary was envisaged by RBI and in-principle approval was given for eight Local Area Banks. The local area banks were very small banks operating in limited area, mainly in semi urban and rural areas, on a very low budget. In 1998 Kisan Credit Card was introduced to provide timely credit to the farmer. In 2002 Government started giving Priority Sector Lending target to banks

In 2006 the concept of having Business Correspondents (BCs) and Business Facilitators (BFs) for last mile connectivity was rolled out for the first time by the Reserve Bank of India to further the cause of financial inclusion. In 2016 the PSL guidelines was revised and the categorisation of PSL based on direct and indirect lending was dismantled and new classification based on Farm Credit , Agriculture Infrastructure credit and credit for ancillary activities was introduced.

**Figure 4.10:** Initiatives towards Rural Intervention by Government and RBI Post the Economic Reforms

Figure 4.11 shows the flow of ground level agricultural credit which has constantly increased over the years highlighting the effectiveness of RBI policies towards enhancing the credit delivery in rural areas.

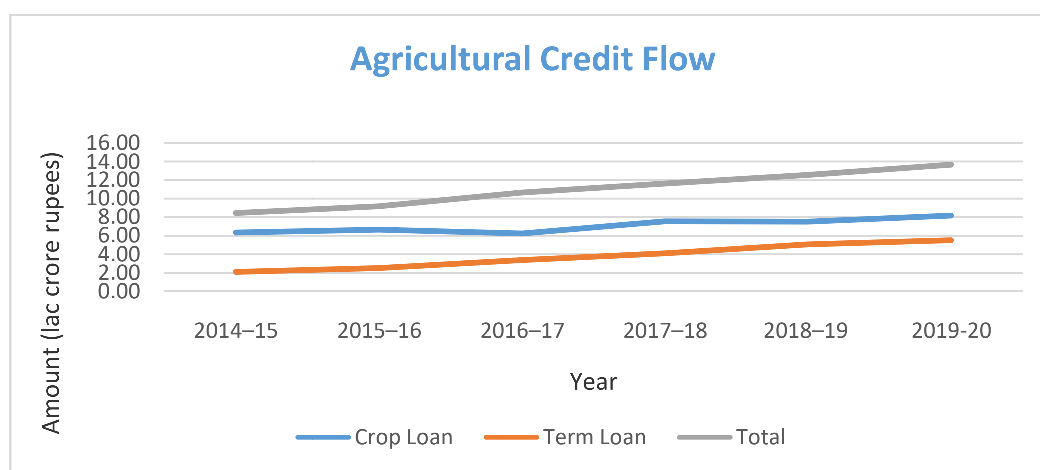



**Figure 4.11:** Agricultural Credit Flow | **Source:** NABARD Annual Report

The share of Agriculture Credit to Agriculture Gross Value Added at current prices has grown over

the year as seen in Figure 4.12. It increased from 40.36% to 45.60% in 2018-19. It is expected that increase in agriculture credit will have positive impact on agriculture production. This also vindicates the effectiveness of the policies of the Government & RBI towards disbursement and delivery of agriculture credit.

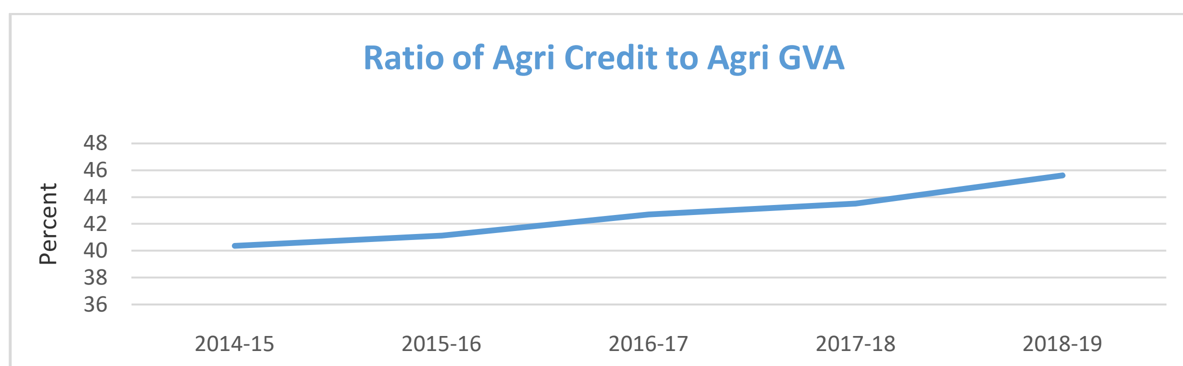



**Figure 4.12:** Ratio of Agriculture Credit to Agriculture GVA | **Source:** NABARD Annual Report

Despite the commendable performance of RBI in spreading the semi urban and rural banking network and increasing the credit flow, a common problem of consistently rising levels of over dues, cutting across various states as well as the various lending agencies operating in the country. The high incidence of over dues in the rural credit system became a major constraint to expansion and smooth delivery of credit.

Undeniably, initiatives by RBI have widened the reach of rural banking to nook and corners of the country and helped to curb the menace of moneylenders. It has also brought more and more unbanked population under the umbrella of institutional banking and thus helped to develop a banking ecosystem. The initiatives have also supported the Government in implementing the anti-poverty and employment generation programmes in the remote areas of the country. However, the problem of loan recovery continues to subvert all the good work that has been done to augment delivery of rural credit.

**Summary**

1. Banks are financial intermediaries which provide different services to the customers. In its pure form, banking is defined as a financial institution authorized to receive deposits and make loans.
2. Bank pools the savings and invests it in businesses which are in need for fund. In this manner the banks provide credit opportunities for people and businesses who require funds.
3. The essential functions of banking can be divided in two parts: Accepting deposit from customers and Lending money to customers.
4. A person who associates with the banker in respect to the crucial tasks of the banks i.e. mobilizing deposits and lending of money, may be termed as the customer of the bank.
5. Proprietary and partnership firms and Joint Stock Companies or any other legal entity can become customer and avail the banking services.
6. The bank checks the identity and location of residence of the person intending to open an account, by scrutinizing certain specified documents. This is known as KYC procedures.
7. Deposit account forms the major source of fund for the bank. Deposit products are divided into three groups: Demand, Term and Hybrid deposits.

8. The Non-Resident Indians can open either an Ordinary Non- Resident (NRO), Non-Resident External or FCNR account with the bank.
9. The three key features of KYC policy are: 1-Customer Acceptance, 2-Customer Identification and 3-Ongoing Monitoring of transactions
10. KYC is necessary for Non-Legal Entities also like account opened by trust or account opened by companies or client account opened by professional intermediaries.
11. When a bank accepts deposits as a part of its primary function, it becomes a debtor and the depositor becomes the creditor to the bank.
12. When banks collect cheques, draft, bill of exchange, dividend, interest etc. on behalf of customer and credit them to the customer's account or sells and purchases securities and makes payments of various dues of the customer then it performs the agency function.
13. When a banker executes any activity not as a part of its routine business operations but on specific instruction from the customer his role is of a trustee.
14. A Banker enjoys certain rights and obligations with respect to his relationship with the customer.
15. Regional Rural Banks were set up in 1975 as a State Sponsored, region specific, low cost structure specifically focused on banking in rural areas.
16. The regional rural bank were established with shareholding participation of Central Government (50%), State Government (25%) and sponsoring public sector bank (25%).
17. Poor recovery and rising NPAs is a concern for RRBs. Recapitalisation and amalgamation of loss making RRBs is a strategy which Government is following to cope up with their poor performance.
18. Medium Term Loans are those which are repayable within 2years to 5 years or maximum up to 7 years taken generally for purchasing agricultural machinery, tractor, livestock etc.
19. A negotiable instrument is defined as a signed document where one party agrees to pay an agreed amount of payment to another party or to his assignee. It is governed by Negotiable Instruments Act 1881
20. A Negotiable Instrument can be in different forms like Promissory Note or a bill of exchange or bearer cheque or a cheque which is payable to order.
21. The Banking Regulation Act, 1949 embodies the rules and regulation that are applicable to all banking firms operating in India.
22. A co-operative society is an independent alliance of persons who connect voluntarily to accomplish their common economic, social and cultural necessities and desires through a mutually owned and democratically-administered enterprise. Co-operative Societies are governed by Co-operative Societies Act 1904.
23. NABARD was set up in 1982 as a new organisation with the objective of giving undivided attention, assertive guidance and sharp emphasis to problems related to delivery of rural credit and issues linked to development in rural areas.
24. RBI has played an exemplary role in widening the reach of rural banking to nook and corners of the country, to curb the menace of moneylenders and to take the reach of the Government anti-poverty programmes to the last mile.

**Questions**

1. What is the role of bank in a developing economy?
2. What are the various classification of Banks in India?
3. What are the various types of deposits?
4. What are the three essential features KYC policy?
5. Why is KYC Compliance necessary for a banker?
6. Explain the rights and obligations of a banker?
7. What are the objectives of establishing the Regional Rural Banks?
8. What are the characteristic features of Regional Rural Banks?
9. Name the three types of Negotiable Instruments and their common characteristics?
10. Mention the seven principles of co-operative structure?
11. What are the duties of a registered co-operative society?
12. Elaborate the functions of NABARD.
13. Elaborate the contribution of RBI towards rural banking?

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# Chapter 5 Role of IT in Rural Banking

## Introduction

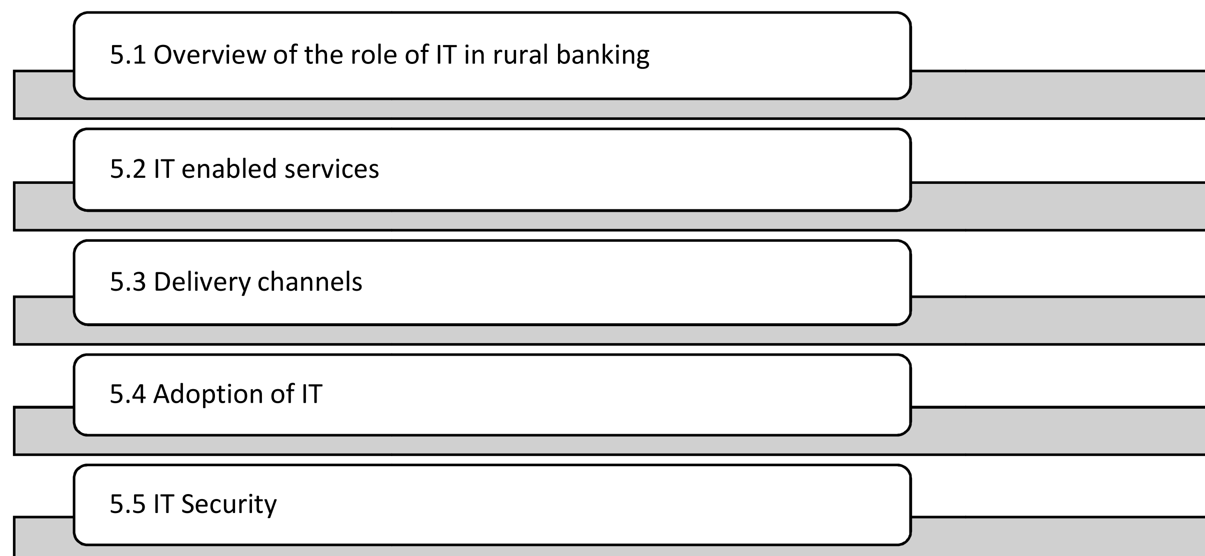
This chapter covers the role of IT in rural banking. The discussion about different forms of IT enabled services has been done. The existence of different types of delivery channels for rural areas has been discussed. Merely presence of technology will not help, hence issues related to the adoption of technology by banks as well as customers has been discussed. The IT has its own security threats, which organizations as well as customers should be aware of and take steps to overcome it.

## Objectives

The objective of the chapter is to familiarize the students about the role of IT in rural banking. The students should be in a position to understand the functioning, of IT enabled services, adoption of IT by the organization and consumers, and security problems associated with IT.

1. To familiarize the students about role of IT in rural banking
2. To appreciate the IT enabled services
3. To understand the delivery channels available in rural banking
4. To comprehend the issues related to adoption of IT
5. To gain knowledge of security related issue of IT

## Structure




## 5.1 Overview of the Role of IT in Rural Banking

India is agrarian society and a large proportion of people still live-in rural area. In this scenario, the importance of rural banking is manifold and has been recognized by various stakeholders like regulators, government, banks etc. Each of the stakeholders has attempted to reach rural population through various programs. For example, Reserve bank of India has made the provision of Priority sector lending. But, the results of these attempts are less than desired and there is still unbanked population in rural area. The reasons cited by many people are remoteness, costlier etc. It is in this situation that technology becomes handy and helps in reducing some of these barriers. The role of

finance in economic development is well established. In this perspective, if certain segment of society is unbanked, it has adverse impact on the economy. Technology can help in reducing this gap by providing access to financial services at reduced cost. The integration of these unbanked populations would help in economic development of the country.

Technology helps in increasing the efficiency and facilitates smooth transaction in the banking sector. It reduces time taken for transactions and increases the flow of funds in the economy. Given the increasing use of mobile and penetration of internet, it will help in covering a large number of unbanked populations. Technology also brings better customer engagement and service quality for the customers. The use of technology improves the documentation process and reduces human error. But, at the same time, there are security issues related to it, about which banks as well as customers should be aware of. Environment has taken center stage in business organizations; every effort is being made to reduce any environmental hazard happening because of functioning of organizations.

The use of technology helps in reducing paper work and becoming environmentally friendly for the banks. All the more, it reduces the cost of transaction and operation for the banks. In addition, technology can be used to improve the employee experience. We are living in an era, where employees are being called as "internal customers", and organizations need to treat them well. Only satisfied employee would deliver a service, which will delight customers. In this direction, technology can be very handy to improve the experiences of employee by smoothening the processes involved in the service delivery by organizations.

Technology becomes helpful in empowering employees by providing good support system in place. It helps in taking faster decision making leading towards improved experience of employees. Organizations enable employees to perform the work efficiently using technology. Smooth flow of information across the organizations has improved the ability to access to information required. In addition, technology has also helped in increasing transparency in the organizations. These factors have improved the employee's experience of working with banks. Better experience of employees has lead towards retention of the employee. They feel affiliated with the bank. In addition, they not only perform the work assigned but also go beyond and explore additional work which can be performed by them. The multiple benefits of technology helps in reducing environmental hazards and are sustainable in nature.

Use of technology also helped organizations to increase accountability of employees. The supervision and monitoring also improved and at the same time cost also reduced. Organizations have increased responsiveness towards multiple stakeholders. The use of technology has also helped in increasing the intelligence of organization e.g., use of Customer Relationship Management technology gave better insights of consumers and increased consumer engagement.

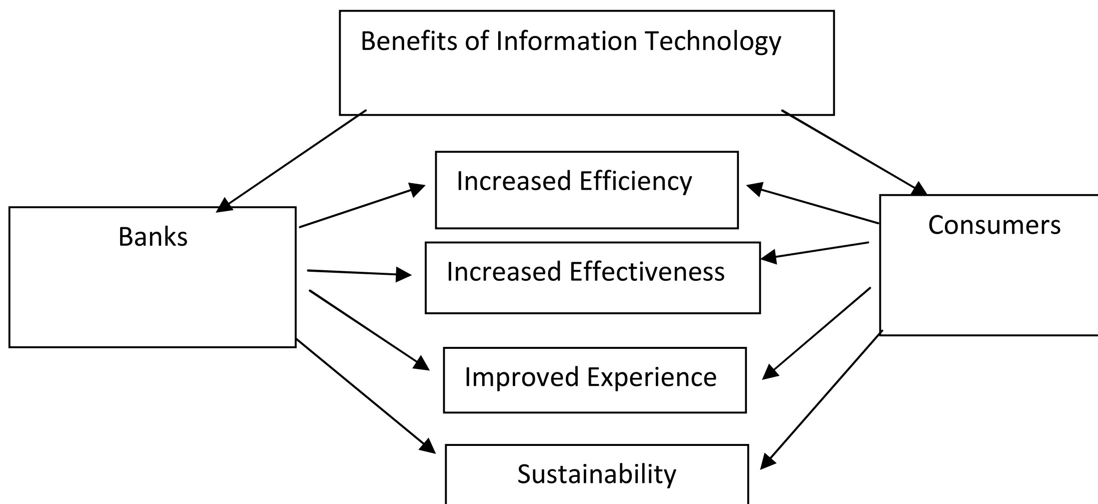



**Figure 5.1:** Benefits of IT (Source: constructed by authors)

Customers also reaped the benefit of technology in terms of increased efficiency by having access to products/services at lower cost. Technology also helped them in getting effective products/services as per their needs. The ability to the respond to various queries from the organizations also improved. Communications with organization increased qualitatively as well quantitatively. The increased information has helped the organization to design more suitable products leading to customer getting the desired products/services. Customer experience has enriched through proper utilization of technology as products can be availed without any time and space constraint.

To enable the use of technology in banking sector, one indicator is digital payment readiness index. India stands quite comfortable in this index by having the score of 1.67 out of 3, when maximum score of a country is 1.85.

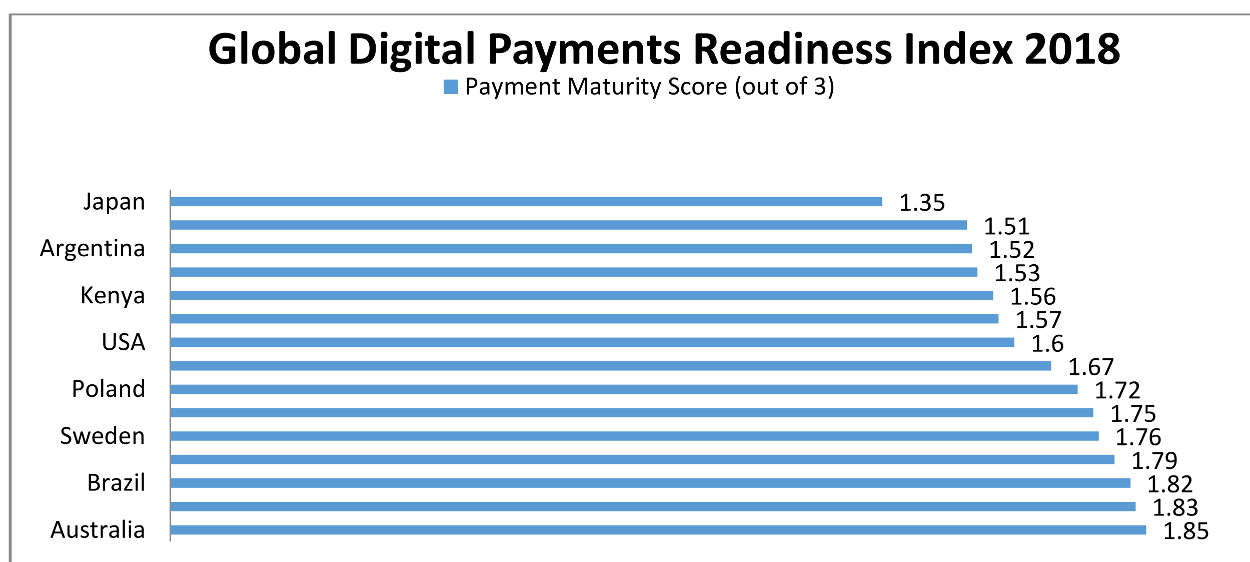



**Figure 5.2: Global Digital Payments Readiness Index 2018** (Source: https://www.statista.com/statistics/224210/global-mobile-payments-readiness-index-by-country/)

In terms of infrastructure available for rural banking in India, one can see the improvement in terms of internet subscribers as well as number of wireless subscribers in rural area. Maximum growth is witnessed in the usage of internet, which is going to increase further with expansion of broadband facility in the rural area. The government has connected all Panchayats (the lowest administrative unit in our country) with broadband facility leading towards increased connectivity in villages. Number of smart phone users have also increased, which has contributed towards increased penetration of internet in rural area of the country.

**Table 5.1:** Number of Internet Subscribers and wireless subscribers in rural India

| | 2019 | 2018 | 2017 | 2016 | 2015 |
|---|---|---|---|---|---|
| Rural Internet Subscribers (in Millions) | 227.01 | 145.83 | 136.52 | 111.94 | 107.57 |
| Rural Internet Subscribers per 100 population | 25.36 | 16.41 | 15.49 | 12.8 | 12.41 |
| Rural Teledensity | 57.13 | 58.67 | 56.47 | 50.88 | 47.78 |
| Rural Wireless Subscribers (in Millions) | 511.32 | 521.23 | 497.76 | 444.84 | 414.18 |

Source: Annual reports, TRAI

Banks as well as customers are required to take action to reap the benefits of technology. As far as customers are concerned, they have access to facilitating factors like internet and smart phones; the numbers have increased manifold in recent times. But the concern is about the adoption of banking practices through the digital channel. The security related to a very sensitive issue like money should be fool proof in addition to positive attitude towards these digitization processes.

On similar note, banks also need to make effort towards digitizing many possible functions. Although, there is movement in that direction, there are various issues which need to be addressed to bring the benefit of digitization in rural banking.

### 5.2. IT enabled services

Technology is being used to provide a wide range of services. There are multiple ways technology can help in automating many services. Some illustrative possibilities are mentioned below as suggested by Froehle and Roth, (2004):

1. Face to face consumer contact
   A. Technology free (no technology involved, serve through interaction)
   B. Technology assisted (only employee uses technology and serve through interaction)
   C. Technology facilitated (both customer and employee uses technology as well as interact with each other)
2. Face to screen consumer contact
   A. Technology mediated (both customer and employee uses technology without direct interaction with each other)
   B. Technology generated (self-service) (only customer uses technology without direct interaction with employee)

**Characteristics of Services**

Services have distinct characteristics namely intangibility, inconsistency, perishability and inseparability. Intangibility refers to lack of physical entities like goods, because of which of it can be touched and displayed. Inconsistency means lack of standardization; organizations cannot guarantee similar level of service every time, because of human involvement in providing the services. This inconsistency may arise because of employee as well as customers as input from both of them are essential to provide services. A perishability aspect of services is linked with the inability to synchronize the supply and demand by making inventory as well as inability to return once consumers consume it. Inseparability means the presence of service provider as well as consumer to perform the services. Each of these characteristics poses some challenge for the organizations. The use of technology helps in removing challenges posed by these characteristics.

Here, we need to remember that IT enabled services should not be restricted to customers only; it should be targeted at all stakeholders. To make it happen, it is necessary that organizations map various activities which can be performed used information technology. The exercise should enable organizations to know the possibility and feasibility of automation at various functional departments in the organization i.e., Human resource, Finance, Logistics, Marketing etc. For example, marketing department can broadly automate some activities mentioned below and similar activities should be identified for each functional area of the organization.

**Table 5.2:** Automation in marketing department

| **Broad area** | **Activities** |
|---|---|
| Sales force | • Account management<br>• Pipeline management<br>• Activity management<br>• Product encyclopaedias<br>• Contact management<br>• Product configuration<br>• Contract management<br>• Product visualization |
| Service | • Activity management<br>• Agent management<br>• Case assignment<br>• Case management<br>• Contract management<br>• Customer communications management<br>• Customer self-service<br>• Scheduling, Queuing and routing<br>• Service analytics |
| Marketing | • Marketing campaigns<br>  • Campaign management (Email campaign management)<br>  • Event-based marketing (Trigger marketing)<br>  • Tele marketing<br>• Digital and online marketing<br>  • Online marketing |

| | <ul><li>Content management</li><li>Keyword marketing (Search engine optimization)</li><li>Social media marketing</li><li>Digital analytics</li></ul> • Strategic and other marketing <ul><li>Marketing performance management</li><li>Marketing resource management</li><li>Loyalty management</li><li>Market segmentation</li><li>Product lifecycle management</li><li>Marketing analytics</li></ul> |
|---|---|

Source: Kumar & Reinartz, (2012)

But, while making these kinds of exercise, organizations need to find out the preference/needs of customers in terms of availing these services. Unless, they value and appreciate it, the exercise will not be fruitful. If some customers are not appreciating, then organization may attempt to find out the reason behind and solve the problem before implementing these kinds of changes.

Banks can use IT to provide existing services as well as creating new service exclusive to these channels using technology like cloud service. Customers are also showing their increasing interest in technology-enabled services being provided by banks, which is evident from figure below.

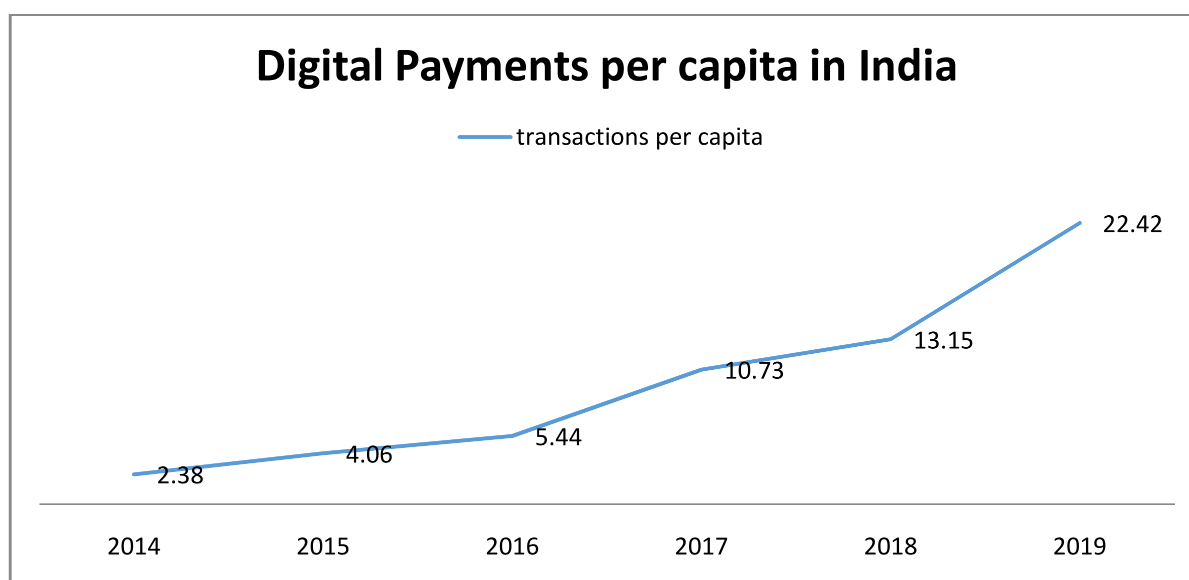



**Figure 5.3:** Digital Payments per capita in India | **Source:**
https://www.statista.com/statistics/1028027/india-digital-payments-per-capita/

Digital payments are seeing increased across the globe, it is forecasted that global digital payments market is expected to grow from 3.7 trillion dollar in 2019 to 12.4 trillion dollars by 2025. With the increasing awareness, we see tenfold increase in digital payments per capita in our country within 5 years of time. In terms of value of these transactions with respect to Gross Domestic Product of our country, can be seen from the table below. It shows the potential of technology, its proper implementation would help us achieve many desired goals of our country.

**Table 5.3:** Digital Payments as a percentage of GDP

| Year | Percentage of GDP |
|---|---|
| 2014-2015 | 561 |
| 2015-2016 | 579 |
| 2016-2017 | 644 |
| 2017-2018 | 726 |
| 2018-2019 | 769 |

Source: Deepening digital payments report by RBI

To provide good services, technology should be in a position to a) perceive the needs of customers, b) think about how to solve the needs, c) connect with customers, d) have interactive communication system in place, e) visualize the solutions and f) act on the feedback provided by customers on the initial solution provided to them.

IT has enabled the access to various relevant banking services in rural area. It has also helped various types of organizations like NBFC, FinTech, Payment Banks, Small Finance Banks, and Microfinance Institutions in reaching the unbanked population of our countries. Services like deposit and withdrawal of cash, remittances, loan, financial literacy, information related to account etc. are easily being done in rural banking space with the use of technology. Banking correspondent model also came handy in spreading the banking services using technological devices.

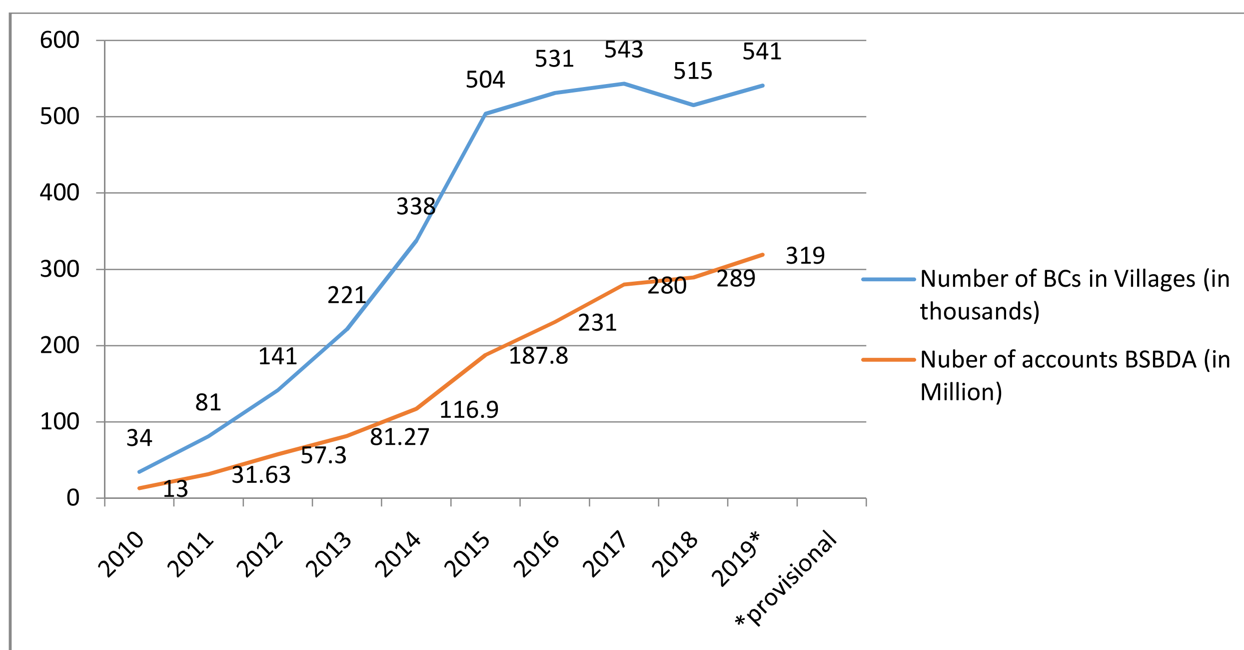



**Figure 5.4:** Performance of Business Correspondents over the years (Source: https://www.rbi.org.in/Scripts/StateRegionATMView.aspx)

Computerization of bank branches in rural area has enabled them to provide the benefits of NEFT/RTGS etc. services to rural consumers. Technology has also enabled financial players to fasten the Know Your Customer (KYC) process. In rural area, remittances from cities are one of the important sources of income for people and with the increased use of technologies it has become easier for people to send/receive money in real time basis. Mobile has also helped in increasing the use of technology enabled financial services in rural area. Customers are using mobile phones for knowing the balance, doing transaction etc. It has also helped in increasing financial literacy in the

rural area. With the increasing use of technologies like Blockchain, Artificial Intelligence, Cloud Computing, Robotics, Biometrics, Internet of Things landscape of rural banking services is going to change drastically.

### 5.3 Delivery Channels

With the increasing use of digital space, we have multiple delivery channels available for our customers. The performance of channels like Debit cards, Credit cards, Point of Sales (POS) and ATMs indicates the moods of customer in terms of their preferences to use multiple channels. Debit cards have highest penetration, which can be used at multiple platforms offered for financial services. Penetration of credit cards is also increasing, but it is not very prevalent in rural area of the country. POS is also increasingly becoming popular and has increased the convenience of retailers as well as customers. ATMs have become very popular medium for the customers but its viability is still in question, especially in rural area where value of transactions is not very high. It can be seen from the figure that number of ATMs in rural area is around 20 percent of total number of ATMs available in the country.

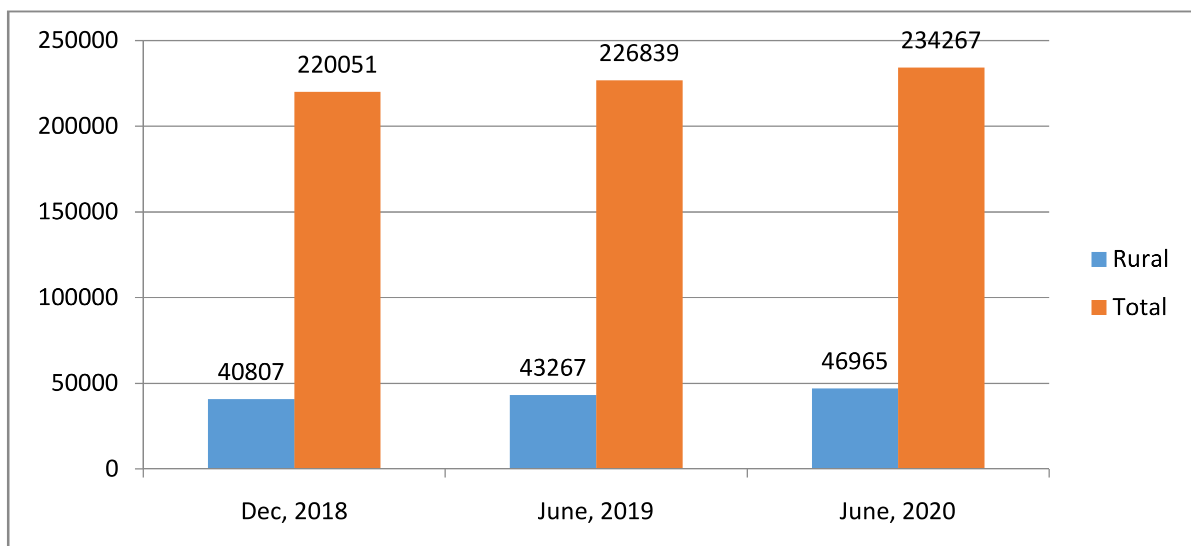



**Figure 5.5:** Number of ATMS in rural area
(Source:https://www.rbi.org.in/Scripts/StateRegionATMView.aspx)

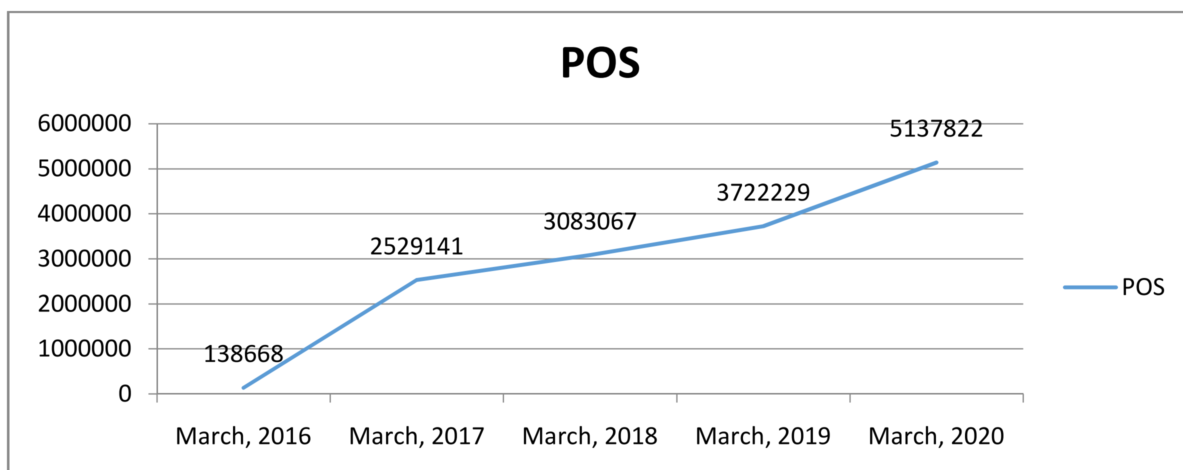



**Figure 5.6:** Number of POS over the years (Source:https://www.rbi.org.in/Scripts/ATMView.aspx)

Number of POS has increased phenomenally in the country leading towards increased use of digital platforms. The penetration and usage is likely to increase with improved awareness and less transaction hassle involved.

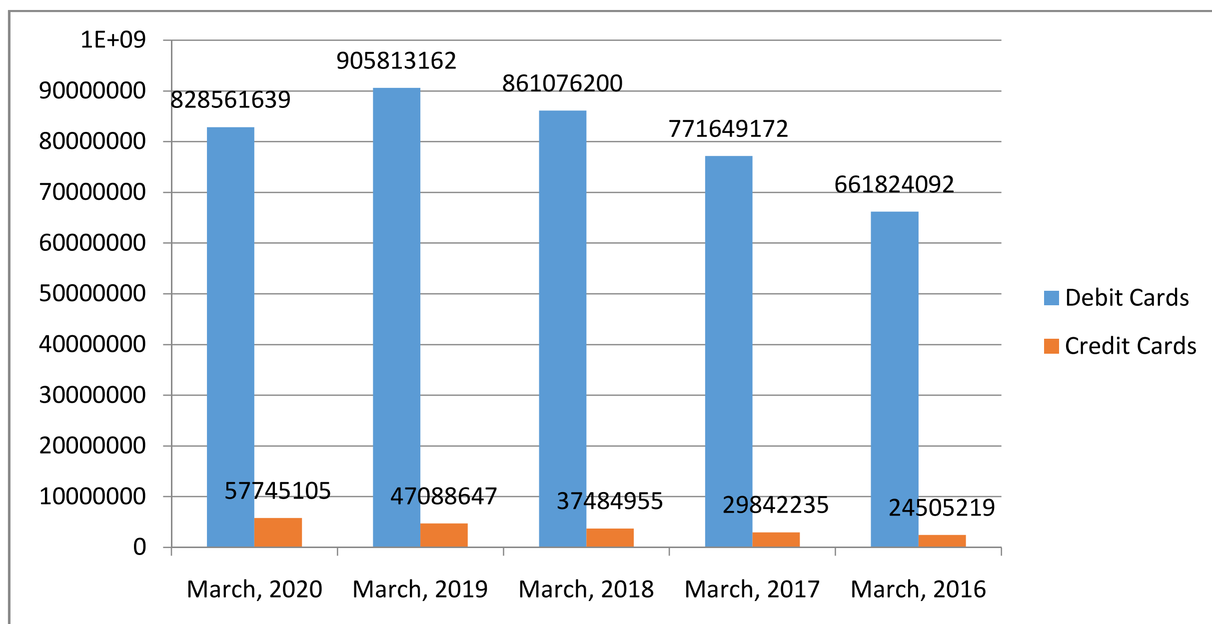



**Figure 5.7:** Number of Credit cards and Debit cards (Source: https://www.rbi.org.in/Scripts/ATMView.aspx)

In addition, for rural area, Jan Dhan-Aadhaar-mobile trinity have increased the penetration of financial service. Jan Dhan (Pradhan Mantri Jan DhanYojana) is a popular program of central government to increase the financial inclusion in the country. Aadhar is a unique identification card, reducing the problems of paper to establish the identity issues of customers. Mobile penetration has increased exponentially in rural area, which can be seen from the tele density and number of wireless subscribers in our country.

To increase the digital presence, government has launched many initiatives; some of them are mentioned below. The growth for India's digital payments has come because of multiple retail payment products launched including Bharat QR, Aadhaar Enabled Payment System, National Electronic Toll Collection, Bharat Bill Payment System, and Rupay Cards.

**Unified Payments Interface (UPI)**

National Payments Corporation of India launched UPI in 2016. It is a real-time payment system, which can be used for transacting with peer to peer as well as peer to merchant. Using it NPCI came up with BHIM UPI (Bharat Interface for Money, Unified Payments Interface) app which is very simple and easy to use app. Payments can be made using UPI ID or by scanning the QR code. Customers can also receive money using UPI ID.

**Table 5.4:** UPI Products Characteristics

| Year | No. of Banks live on UPI | Volume (in Mn) | Amount (Rs. in Cr.) |
|---|---|---|---|
| April,2016 | 21 | 0 | 0 |
| April,2017 | 48 | 7.2 | 2,271.24 |
| April,2018 | 97 | 190.08 | 27,021.85 |
| April,2019 | 144 | 781.79 | 142,034.39 |
| April,2020 | 153 | 999.57 | 151,140.66 |
| August, 2020 | 168 | 1618.83 | 2,98,307.61 |

Source: https://www.npci.org.in/product-statistics/upi-product-statistics

Seeing the popularity of BHIM, banks also have started promoted their UPI-apps by prefixing BHIM before the name of their apps. UPI based apps have contributed significantly to improve the digital payment and has created an ecosystem conducive for mobile-based digital transactions in the country.

**Bharat Bill Payment System (BBPS)**

BBPS works as a one-stop system for paying bills by providing an integrated, interoperable service. It uses a network of institutions, multiple modes of payments and confirms payment instantly. The idea is to route all recurring payments (electricity, gas, school fees, insurance premiums etc.) through this system.

**Table 5.5:** BBPS transaction volume

| Year | BBPS transaction volume (in millions) |
|---|---|
| 2017 | 0.03 |
| 2018 | 10.6 |
| 2019 | 73.5 |
| 2020 | 145.7 |
| 2021 | 269.5 |
| 2022 | 409.7 |
| 2023 | 569.5 |

**Source:** Empowering payments - Digital India on the path of revolution

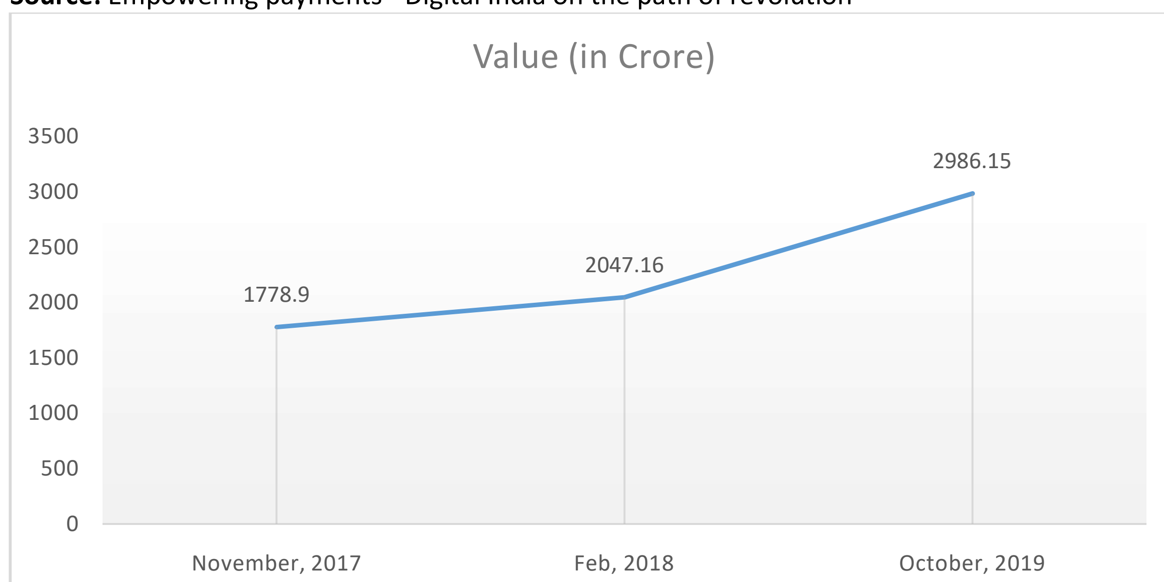



**Figure 5.8:** Bharat Bill Payment Statistics (Source: https://www.bharatbillpay.com/whatsnewUpdates.php)

Increasing penetration of BBPS in terms of volume as well as value is testimonial of its popularity. The small ticket size, which reflects in volume of its use, reflects its relevance for low-income population.

**Bharat QR**

A Quick Response (QR) based payment system was launched by NPCI to enable fast digital commerce. User has to scan to pay rather than swipe their cards. It is interoperable making the payers work easier. It has been jointly developed by four major card payment companies—MasterCard, Visa, RuPay and American Express.

Customers of any bank would be in a position to pay using QR code with their debit/credit cards. Sellers also will be able to avail unique QR code irrespective of card network being used by customers, resulting in better acceptance infrastructure. It brings improvement for informal establishments with low technology adoption and having problem in affording high end technology products like computer/POS machine. Customers need to download bank's Bharat QR enabled app and use the scan facility of it at seller store for making transaction. Once the payment is successful, both customer as well as seller receives notification about the transaction.

**Aadhaar Enabled Payment System**

Aadhaar Enabled Payment System is a model led by banks, which allows interoperability of transactions Point of sale as well as Micro ATMs by authenticating through Aadhaar. It is commonly being used by business correspondents or bank mitra, making it a very effective medium of financial inclusion in our country.

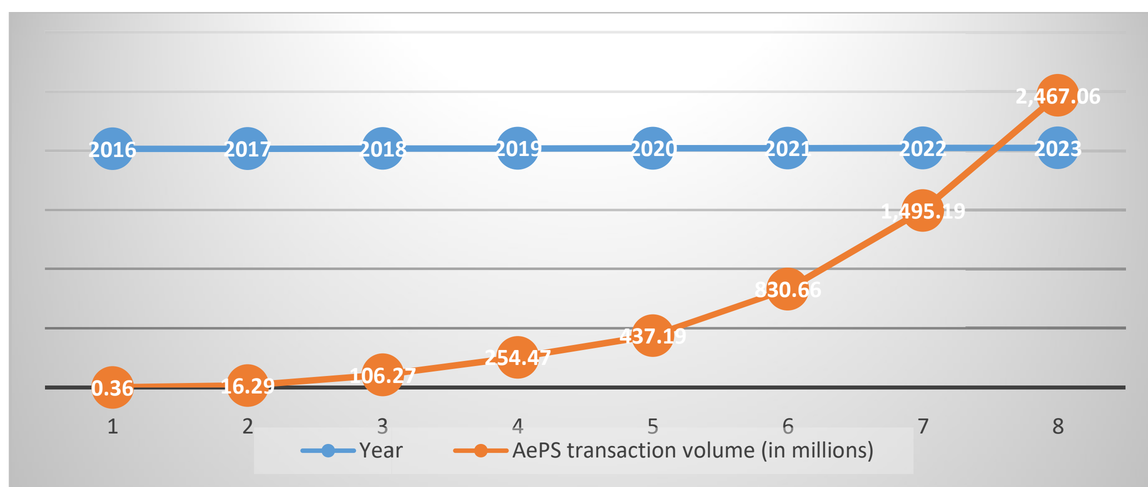



**Figure 5.9:** AePS transactions over the years | **Source:** Payment Council of India and PWC, 2020

The penetration of AePS transactions shows that it is using the presence of Aadhar to facilitate the banking services in rural area. The inputs required are IIN (identifying the customer's bank), Aadhar number and fingerprint of the customer.

**National Electronic Toll Collection (NETC)**

NPCI developed NETC to meet the need of electronic tolling system of our country. It also works on interoperability principle and allows customers to use their FASTag to pay toll at any toll plazas without any hindrance in terms of operator of the toll plaza. Customers need to link their FASTeg with their bank account. FSATeg is fixed on the vehicle and facilitates the payment using Radio Frequency Identification (RFID) technology.

**Table 5.6:** NETC Transaction over the years

| Year | NETC transaction volume (in billions) | NETC transaction value (in billions) |
|---|---|---|
| 2018 | 126.5 | 33.4 |
| 2019 | 254 | 57.4 |
| 2020 | 580.2 | 112.9 |
| 2021 | 638.2 | 124.2 |
| 2022 | 1,212.50 | 223.6 |
| 2023 | 2,121.90 | 384.6 |

(Source: Payment Council of India and PWC, 2020)

**RuPay card**

NPCI launched RuPay card in 2012 as a result to RBI's mandate to build a domestic multilateral payment system. The card is available in multiple variants with an aim to cater the needs of Indian consumers.

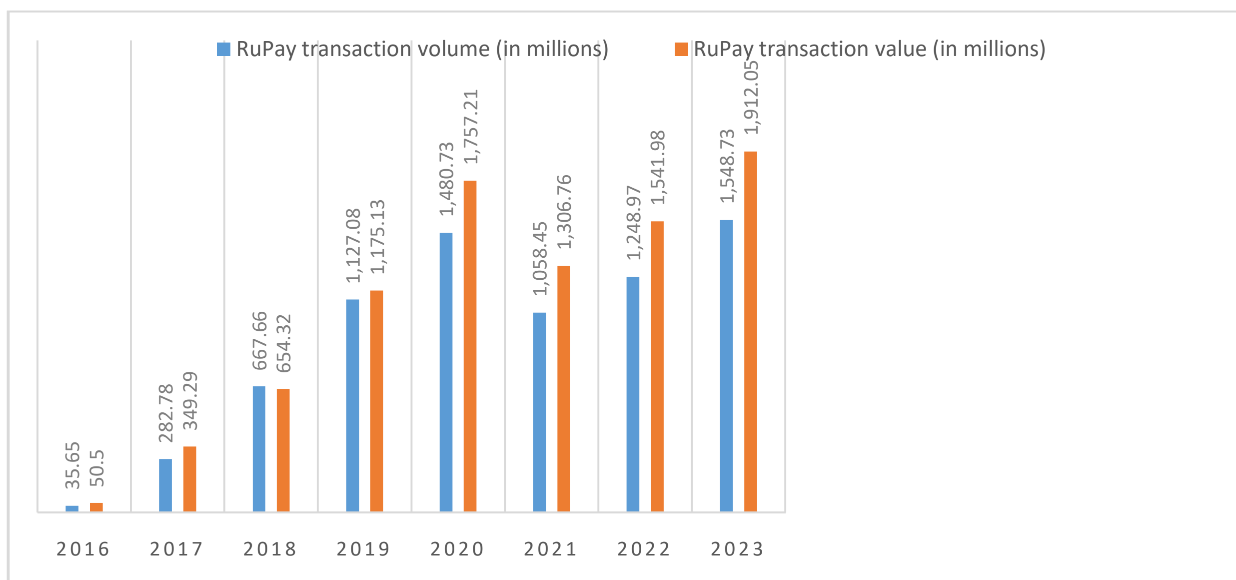



**Figure 5.10:** RuPay card transactions over the years | **Source:** Payment Council of India and PWC, 2020

RuPay is indigenous card aimed at making India a "less cash" economy. The name derived by combing the words "Rupee" and "Payment". It is widely accepted at ATMs, POS and e-commerce websites. This product is promoted by NPCI and works on very high secure network.

**Unstructured Supplementary Service Data (USSD)**

To further the financial inclusion, USSD includes *99# service, which works for mobile banking.It fulfills the need of low volume remittances required on immediate basis. Given the large number of migrant labors in our country, it may prove very fruitful for the consumers.

This innovative payment service allows mobile banking transactions using basic feature mobile phone. It does not internet facility. It has been designed, keeping in mind the large number of basic phone users especially unbanked population of the country. Customers avail this service by dialing *99#, which gives them access to an interactive menu. The services which can be availed by using this service include, interbank account to account fund transfer, balance enquiry, mini statement besides host of other services.

**National Automated Clearing House (NACH)**
NACH is launched by NPCI to cater the needs of institutional players to facilitate their high volume transactions. It also smoothen the repetitive transactions like pension, salary, dividends being paid by the organizations.

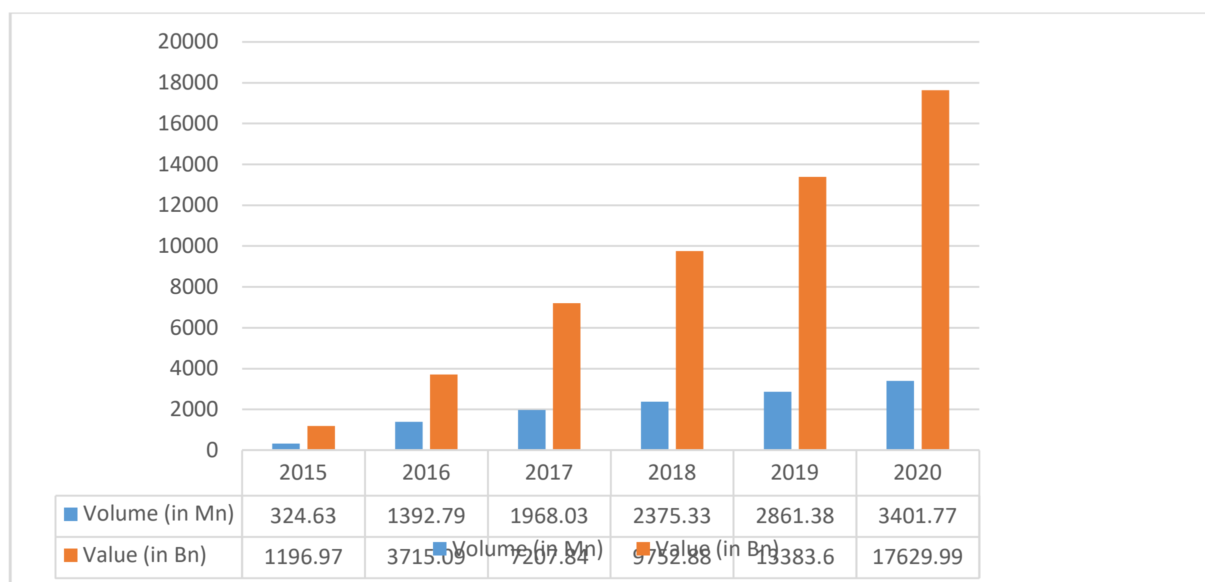



**Figure 5.11:** NACH transactions over the years (Source: https://www.npci.org.in/sites/default/files/RETAIL-PAYMENTS-STATISTICSAug-2020.xlsx)

With the increasing presence of Fintech companies, financial sector of India as well as globally will see unprecedented rise of digital products/services. It will lead towards many changes, which will force the existing players to modify their operating system, collaborate with multiple players to deliver superior value to customers.

## 5.4 Adoption of IT

Adoption of technology is required for both parties i.e. banks as well as customers. There are theories explaining the adoption behavior, which is equally applicable to both individuals and organizations. If any parties fail to adopt, it is going to reduce the benefits of technology and investments made would not be used optimally. There are different types of adopters with varying characteristics, efforts should be made to identify the customers/organizations falling into those category. It may vary based on the products/services for which exercise is being made. After identification, one can make strategy for enhancing the chances of adoption by creating conducive environment for it.

**Table 5.7: Type of adopters**

| Type of adopter | Description | Percentage in population |
|---|---|---|
| Innovator | Highly educated, uses multiple source of information, enterprising | 2.5 |
| Early adopter | Leaders, average education | 13.5 |
| Early majority | Thoughtful, good informal contacts | 34 |
| Late majority | Doubtful, average informal contacts | 34 |
| Laggard | Fearful, sources of information are limited | 16 |

Here, organizations should also see the frequency of use as it may happen that after adoption customers are not using it frequently. Diffusion will happen because of a) Cost of adopting becomes less because of learning curve and b) Benefit rises (appreciating the value or more functions get introduced). Adoption category can also be linked with product life cycle (introduction, growth, maturity and decline) and match strategy to fit the requirement of phases of life cycle with type of adopters. Technology adoption has been used by various researchers using multiple theories. Some of the illustrative theories are listed below (Singh et al. 2014):

a. Theory of reasoned action
b. Motivation theories
c. Technology acceptance model
d. Innovation diffusion theory
e. Social cognitive theory
f. Theory of planned behavior
g. Unified theory of acceptance and use of technology model

Using these theories, researchers have identified various variables which impact technology adoption in general. These variable ranges from being intrinsic characteristics to extrinsic rewards. It covers cognitive, affective and behavioral dimensions of individuals. Adoption by organizations also can be thought in similar fashion. In a meta-analysis of technology adoption in banking context, Santini et al. (2019) identified multiple variables used of many researchers to explain the phenomenon. They categorized it as antecedents and consequences. Banks need to make sure that they are working on these dimensions to ensure higher level of adoption and reuse of technology being deployed by them.

**Table 5.8: Variables discussed to understand the adoption of banking technology**

| Variable | Description |
|---|---|
| **Antecedents** | |
| Self-efficacy | Behaviour, knowledge and ability to handle digital platform |
| Compatibility | Compliance with consumers values and beliefs |
| Perceived awareness | Awareness about advantage/disadvantage |
| Discomfort | Perception of losing control |
| Involvement | Relevance based on needs, values and interest |
| Age | Age of customer |
| Social influence | Importance of other's opinion |
| Innovativeness | Level to adopt new ideas |
| Web-design perception | Attractiveness of digital platform |
| Accessibility | Flexibility and convenience |
| Credibility | Safety and privacy |
| Cost | Economical to use |
| Enjoyment | Pleasurable experience |
| Risk | Uncertainty about financial, performance, privacy loss |
| System quality | Consistency and speed of system |
| Interaction need | Need to relate with others |
| Infrastructure support | Provision of support system like help desk |
| Response | Responsiveness of organization |
| **Consequences** | |
| Attitude | Affective evaluation of system |
| Behaviour | Inclination to use |
| Satisfaction | Affective and cognitive evaluation of performance |
| Performance | Efficiency of system |

Source: Santini et al. (2019)

Here, banks may use Attention–Interest–Desire–Action (AIDA) framework to impact cognitive, affective and behavioral dimensions. They may also try to find out the reason behind use of technology i.e. hedonic or utilitarian. This information would help in making strategies highlighting the relevant aspect of technology fulfilling hedonic or utilitarian needs.

### 5.5 IT Security

One of the major reasons behind lower adoption of technology in banking sector is the issue of security. In 2019, there were 52,304 fraud cases resulting in loss of Rs. 149 crore. Between 2017-2020, the number of fraud cases reported was 140,471 with a loss of Rs. 589 crore.

**Table 5.9:** Number of frauds over the years

| Year | Number of frauds (Transaction over Rs. 1 Lakh) |
|---|---|
| 2016-2017 | 1367 |
| 2017-2018 | 2127 |
| 2018-2019 | 1477 |

These frauds are happening because of customer as well as bank related issues. Consumers face problems like Malware, Trojan/Screen sharing, Phishing, SMS stealing apps and Fake apps. Many a times, customers are being duped by fraudsters by taking secret information from them. Phishing is a criminal activity using social engineering techniques. Phishers attempt to fraudulently acquire sensitive information, such as usernames, passwords and credit card details, by masquerading as a trustworthy entity in an electronic communication.

Consumers should never share credentials like One Time Password, PIN, CVVs etc. with anyone. They should use multifactor authentication. While using internet, they should always use licensed and trusted software & devices, use endpoint security like antivirus and firewall, allow only required permissions to apps, use caution while installing apps, be wary of shopping from unknown sites/apps, and beware of phishing & other scam methods.

Similar instances from banks side has also been reported where employees were involved in making fraud happen. In addition, there are criminals using technology to dupe customers without their knowledge. The system needs to identify those systemic and rectify them time-to-time. With the increasing load of data, it becomes necessary for banks to make sure that computers and network they are suing are protected from hackers. They need to have processes in place to avoid any data theft, identification of any theft, and policy to deal with those problems. The best strategy would be to be pro-active and make protective environment for multiple threat possibilities. Banks should have a provision to keep a trail of every activity for certain period; it will help them in taking corrective action, if anything goes wrong.

Banks need to identify the threat from multiple sources. Once they know about threat, they should see the vulnerability of system and what impact it will have on the system. There are broadly two types of vulnerabilities a) known and b) unknown. Banks should have some provision for unknown vulnerabilities also. Vulnerabilities can exist without the knowledge of banks also. There may be security issues with an operating system or an application that a hacker has discovered, but is unknown to the software vendor. The impact should be classified from low to high based on the importance of activity. They should also calculate the likelihood of happening it, which will give them

idea about the risk inherent. It will give option to banks to adopt one or more risk management strategy which suits the organization.

a. Risk avoidance or termination(stop doing whatever it is that gives rise to the risk)
b. Risk sharing or transfer (share the risk with a third party, often an insurance company)
c. Risk modification or reduction (find some way of reducing either the likelihood or the impact of the attack)
d. Risk acceptance or tolerance, in which we accept that some things cannot be readily fixed and that we must accept the consequences.

Hayden (2010) provided a framework to classify the risk being faced due to technology by using two dimensions: 1) likelihood of event, 2) severity of impact.

**Table 5.10:** Risk assessment matrix

| | | likelihood of event | | |
|---|---|---|---|---|
| | | High | Medium | Low |
| severity of impact | High | Doomed | Bad | Outlier |
| | Medium | Bad | Not good | Error |
| | Low | Annoyance | Typical | Whatever |

Source: Hayden (2010)

Organizations should be proactive in dealing with these issues and have provision of

1) Detective (put something in place to detect the problem e.g. antivirus software (which will also react to malware it has detected);

2) Preventative (additional facilities in place in an attempt to stop an attack from being successful, such as firewalls;

3) Directive (set out policies, processes and procedures that people must follow in order to reduce the risk, such as password policies).

Otherwise they will have no option but to be reactive and follow corrective measure i.e. try to fix something that has happened as the result of an attack, such as removing infected files and blocking unnecessary ports.

A part of the problem can be resolved by providing financial education to customers as well as employees. The do and don’ts of online should be shared, updated and repeatedly informed to customers to avoid frauds. In addition, regulatory bodies should also take cognizance of these cyber crimes and deal with these criminals sternly. To deal with digital frauds, RBI governor has informed that a central payment fraud registry will be created.

While there are benefits of technology, one should be aware of the paradoxes linked to it and then take an informed decision as well as banks need to make sure to make positive outcome from it. Mick & Fournier, (1998) identified these paradoxes as:

- Control/chaos: regulation/order, upheaval/disorder (if individual/organization is well verse with the system, you will fill in control otherwise it will creates chaos)
- Freedom/enslavement: independence/less restrictions or dependence /more restrictions (use of technology enable individual/organization to do things independently provided one knows its use properly otherwise it will increase dependency on others)
- New/obsolete: bringing recent benefits of scientific knowledge, obsolete by the time reaches market (access to technology provides the opportunity to know about new things faster, but at the same time technology itself has got less shelf time i.e. by the time one knows about it some new technology arrives)
- Competence/incompetence: feeling of intelligence or efficacy, ignorance or ineptitude (If one knows how to operate technology it helps in improving the competency otherwise lack of awareness may lead towards the feeling of helplessness and inferiority complex)
- Efficiency/inefficiency: less or more effort (Technology has helped in increasing the efficiency provided it is used properly and it is working well otherwise it takes extra time when people struggle to use it and creates inefficiency in the system)
- Fulfils/create needs (technology has helped in fulfilling our existing needs but at the same time it has created new needs also)
- Assimilation/isolation: human togetherness or separation (technology has helped us in improving the connect which otherwise was not possible, but increased use of it has also created a situation where we fill isolated)
- Engaging/disengaging: increase involvement/flow/activity, disconnection/disruption/passivity (by using technology we can increase the engagement of individuals and at the same time because of lack of human involvement one may get disconnected )

Although we are seeing the number of cyber-frauds increasing over the years, government has taken initiatives in terms of increasing the awareness level of consumers and constantly updating the cyber laws present in the country.

### Summary

Information technology has revolutionized the functioning of any organization and banking is not an exception. IT has helped in improving efficiency and effectiveness as well as experiences of customers and employees. It has proved to be a way to provide similar or better experience and lesser cost. Organizations and customers need to invest resources for these technologies. To take advantages of technology, organizations as well as customers should adopt it. There are different types of adopter such as innovator, early adopter, early majority, late majority and Laggard. There are multiple variables like Self-efficacy, Compatibility, Perceived awareness, Age, Social influence, Credibility, Cost etc. acting as antecedent for behavioural and attitudinal change in the attitude of

individuals regarding use of technology in banking sector. Here, organizations need to make sure that they have provisions for dealing with security threat involved in using technology. Ultimate responsibility lies with individuals to reap the benefit of technology; same technology which is enabler for one individual becomes disabler for others.

### Model Questions

1. Analyse the advantages and disadvantages of information technology in banking sector.
2. List down activities of any functional department of a bank which can be automated.
3. Discuss various online distribution channels available for online banking.
4. Describe the reasons for adopting online banking technology by customers.
5. Discuss different types of adopter in our society.
6. How cyber-security can be enhanced?
7. Classify risk involved in accessing different technology related products.
8. How paradoxes of technology will impact individuals?

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## Editors' Profile

### Dr W G Prasanna Kumar

Dr. W G Prasanna Kumar, Chairman, Mahatma Gandhi National Council of Rural Education (MGNCRE) prides in calling himself a *Public Servant* working for Climate Change. His expertise in Disaster Management has him in the advisory panels of several state and national level departments. He is also an expert advisor for the government of Telangana in its Disaster Response Force endeavour. A master trainer for Civil Services candidates, he conducts intensive training programs periodically at the behest of nationally recognized training institutes. He is currently actively involved in promoting higher education curriculum addressing rural concerns in India. **"Villagers to be producers not just consumers"** is his conviction that drives him to work for rural challenges. He aspires for an adaptive disaster risk resilient and eco-responsible India. The Curriculum on MBA in Waste Management and Social Entrepreneurship, and BBA and MBA in Rural Management are his major academic achievements dedicated to India's rural concerns. This has culminated in several collaboration MOUs for introduction of MBA/BBA Rural Management in Higher Education Institutions across India.

Dr. Prasanna Kumar excels in taking a vision and making it a reality and a plan into action, driven by a strong motive to achieve. He has translated positive intentions into tangible results. Being clear on the vision, defining a pathway, setting of the track with a clear destination point and quickly taking corrective actions as and when needed – are his prime qualities that make him an Achiever.

Under Dr. W G Prasanna Kumar's leadership MGNCRE has done nationally recognized instrumental work in building rural resilience including rural community engagement and Nai Talim - Experiential Learning. He has guided and helped MGNCRE in making key decisions and implementing agenda in several areas including Nai Talim (Experiential Learning), Community Engagement, Rural Immersion Programmes, Swachhta Action Plan activities, Industry-Academia Meets and Exhibitions on Waste Management, Comprehensive Sanitation Management in villages by working with Higher Educational Institutions, making curricular interventions in Waste Management and Rural Management, compiling Text Books on Waste Management and Rural Management, UNICEF (WASH) activities and several other related impactful activities. MGNCRE has become an interface for Government of India for promoting academic activity focusing on the rural concerns, being an advisor and a curriculum development agency for the Government of India. The Council is also now an RCI for Unnat Bharat Abhiyan.

Another pathbreaking achievement has been the formation of **Cells** through online workshops for institutionalising the efforts of MGNCRE. Vocational Education-Nai Talim-Experiential Learning (VENTEL) discuss MGNCRE's interventions in HEIs and making Vocational Education as a Teaching Methodology; Workshops on Social Entrepreneurship, Swachhta and Rural Engagement related activities in Higher Education Institutions has paid dividends and the key roles of the HEIs is highly appreciated by the Ministry. Building continuity and sustainability is being done through Social Entrepreneurship, Swachhta & Rural Engagement Cells (SES REC). Institutional level Rural Entrepreneurship Development Cells (REDC) Workshops/ FPO/FPC-Business Schools Connect Cells

(FBSC) are organized with the objectives of Functionality of RED Cell; Preparation and Implementation of Business Plan and grooming students to be Rural Entrepreneurs.

A man with many firsts to his credit, and an incredible record of accomplishments, Dr. W G Prasanna Kumar is currently guiding MGNCRE in building a resilient rural India.

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Dr K N Rekha, is a PhD Graduate from IIT Madras. She has 14 years of experience in training and education Industry. She works at Mahatma Gandhi National Council of Rural Education (MGNCRE), Hyderabad as Senior Faculty. She is involved in curriculum development on Rural Management and Waste Management. Prior to this, she worked as a researcher at Indian School of Business, Hyderabad, a short stint at Centre for Organisation Development (COD), Hyderabad. She has co-authored a book on "Introduction to Mentoring", written book chapters, peer reviewed research papers, book reviews, Case studies, and caselets in the area of HR/OB. She also presented papers in various national and international conferences. Her research areas include Mentoring, Leadership, Change Management, and Coaching. She was also invited as a guest speaker at prominent institutions like IIT Hyderabad.

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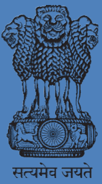


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