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INSTITUTIONAL FINANCING OF RURAL CREDIT SYSTEM IN INDIA

Dr. Sushma Aggarwal*
Ms Sonam**

ABSTRACT

Institutional framework for dispensing rural credit after independence has undergone a tremendous qualitative, quantitative and structural changes. This paper examines the existing rural credit system in India in order to assess how far they have been able to meet the growing credit needs of the rural borrowers. The government policy on rural credit has been one of the progressive institutionalisation aimed at providing timely and adequate credit to rural borrowers. Using data from secondary sources, this paper concludes that non-performing assets and overdues is the major area of concern in rural financial institutions in India. The authors strongly recommend that corrective actions should be taken such as focus on monitoring and supervision of the end use of credit by the borrowers, rather than merely disbursing credit. Many recommendations have been made to convert the loss making Rural Financial Institutions into profitable institutions.

KEYWORDS*: Rural Credit, Rural Financial Institutions, Non-Performing Assets, Cooperatives.*

Introduction

Rural sector is the most important sector of Indian Economy supporting 2/3 of Indian population. Role of rural credit system is very critical for increased production and for enhancing investment in agriculture and other rural allied activities by making available timely credit. The main purpose of this article is to examine the existing system for providing rural credit and to see how far it has been able to meet the growing credit needs of the rural borrowers.

Objective of the Study

In order to achieve the main purpose, the following objectives have been set:

- To examine the existing institutional framework for providing rural credit in India.
- To analyse the performance of different Rural Financial Institutions (RFIs) i-e Cooperative banks, Commercial banks (CBs), Regional Rural Banks (RRBs) and other RFIs in India at the ground level.
- To identify structural deficiencies in the system and operation constraints of RFIs in India.
- To suggest some suitable changes in the existing rural credit system in India.

The paper has been divided into four sections. Section I presents a brief description of the evolution of the institutional set-up of rural credit in India and to examine what are the main RFIs at level constituting the existing structure for providing rural credit in India. Section II deals with the performance, appraisal of grand level RFIs in respect of their geographical coverage, deposit mobilisation and disbursement of loans and advances etc. Section III deals with the problem areas that are being faced by RFIs in India and Section IV presents conclusions and suggestions.

Research Methodology

Secondary source of data has been used for the study. The main source of data for the paper are reports of RBI and NABARD. Simple statistical tools have been used for the study. Secondary data has been gathered from published and unpublished sources including websites, books, journals, magazines, newspapers, RBI annul reports research papers. Simple statistical tools such as averages,

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* Associate Professor, Lakshmibai College, University of Delhi, Delhi, India.
** Assistant Professor, Hansraj College, University of Delhi, Delhi, India.

percentage and ratios have been used for the study. A large number of parameters have been used to examine the relative performance of ground level RFIs in India viz. how far they have been able to provide the branch network in rural areas, how far they have been able to mobilise savings from rural areas, and how far they have been able to meet the credit needs of rural borrowers etc.

Section I

Institutional framework for dispensing rural credit after independence has undergone a tremendous qualitative, quantitative and structural changes both at national level and field level and in process each constituent regional has developed its own characteristic and made its contribution to the overall system of rural finance. The present system of rural credit in India consists of two sectors viz. Non- Institutional and Institutional. The non-institutional sector consists of professional and agricultural money-lenders, landlords, traders, commission agents, relative and friends whereas institutional sector comprises co-operatives, commercial banks and regional rural banks.

The credit provided by private agencies are unfavourable terms and for unproductive purposes and the main objective is not to increase production but to bring the borrowers in the grip of perpetual indebtedness. The agricultural sub-committee remarks that, the money lender often resorts to and take advantage of the necessity of rural borrowers (GOI, 1945) Thus, there was urgent need for development of Institutional framework for providing rural credit. The government policy on rural credit has been one of the progressive institutionalisation aimed at providing timely and adequate credit to rural borrowers. The share of various agencies in providing total rural credit is presented in Table 1.

Table 1: Sources of Rural Credit in India (in % Share)

Credit Agencies	**1951-52**	**1981**	**2022**
1. Non Institutional	93	39	30
Sub Total	93	39	30
2. Institutional			
Govt.	3	4	7
Co-operative	3	29	25
Commercial banks	1	28	38
Sub Total	7	61	70
Total	100	100	100

Source: All India Rural Financial Inclusion Survey AIRFIS, AIRCS Report on All India Best Investment Survey, & RBI, NABARD

From table 1, it is clear that in the field of rural credit, the share of non- institutional sector in total borrowings of farmers has recorded a significant decline from 93% in 1951-52 to 39% in 1981 and further to 30% in 2022. The co-operative credit societies were practically the only institutional source of rural finance in India in the beginning but it was observed a large number of cooperative were neither viable nor potentially viable therefore, in 1970 government of India adopted a multi-agency-system under which both co-operative banks and commercial banks were being developed to meet the growing demand of rural sector. Commercial banks have experimented with a number of alternatives and combinations of methods and approaches in different parts of the county with varying degree of success. These includes building up of a base of technically qualified field officers, lead bank scheme (LBS), service area approach (SAA) group financing, financing through primary agricultural co-operative societies (PACS) and farmer service societies (FSS) etc. Regional Rural Banks (RRBs) have been set up in 1975 for exclusive requirement of "target groups” consisting of small and marginal farmers, artisans, craftsman, scheduled caste and scheduled tribes etc in rural areas. Because it was noticed out of the total assistance provided by commercial and co-operative banks a lion’s share is appropriated by well to do farmers whereas small and marginal farmers receive a meagre share of total credit disbursed by them. The entire infrastructure of rural credit system is headed by Reserve Bank of India (RBI). The RBI has which area of direct responsibility in policy formulation in regard to credit deployment for both co-operative banks and commercial banks.

National Bank for Agriculture and Rural Development NABARD was set up in 1982 as an apex institution to integrate the whole system after providing rural credit from top to bottom by planning, monitoring and supervising rural credit in India. It also provides training to staff and technical consultancy and non-financial help to RFIs. In spite of an impressive expansion of rural credit system, it remained inaccessible to the rural poor. For improving the access of the rural pour few Non Government Organisation (NGOs) and voluntary Organisation (VO) called self- help groups (SHGs) attempted to organise the poor into informal groups and finance them. Recently, there have been efforts to link informal groups with formal rural credit system. Linking SHGs NGOs is one such innovative modality, which have helped to reduce transaction costs and also ensured better repayment performance.

Section II

Performance of Rural Financial Institutions

RFIs in India have achieved a phenomenal growth in terms of providing branch network, mobilising rural savings and disbursing loans and advances over a period of time.

Geographical Coverage by RFIs

There has been manifold increase in total number of branches of RFIs in India. Co-operatives Banks (PACS and PCARDBs) have the widest network of their branches compared to the smallest network of branches of RRBs.

However, from the point of view of growth RRBs have shown the maximum growth in terms of branch expansion. On the other hand the number of PACSs have declined or they have negative growth.

Table 2: Branch Expansion of RFIs

Yr./ Institution	Co-operative Banks	RRBs.	Commercial Banks
1981-1982	94,292	5,393	21,142
1999-2000	1,00,745	14,485	32,771
2020-2021	1,00,159	21,856	52,914

Source: Data from RBI and NABARD

Deposit Mobilisation by RFIs

Co-operative banks have a comparatively insignificant share of total deposit mobilised by RFIs. On the other hand, commercial banks have contributed the a substantial share to total deposits mobilisation. Deposit mobilised by RRBs & MFIs were more compared to co-operative banks despite the fact that they have smaller network of branches.

Table 3: Deposit Mobilisation by RFIs (Amount in Rs. Crores)

Yr./Institution	Co-operative Banks	RRBs
1981-82	324	382
2020-21	2,14602	5,25,226

Source: Data from RBI and NABARD

Loans and Advances by RFIs

Table 4: Loans and Advances by RFIs (Amount in Rs. crores)

Yr./ Institution	Co-operative Banks		RRBs
1982-83	Total	2717	212
2020-21	DCB	304,990	3,15,181
	SCB	2,11,794	
	PCARDBs	15,199	
	SCARDBs	20, 918	
	Total	5,52,901	

Source: Data from RBI and NABARD

Table 5: Agency-wise Credit Flow to Agriculture (Amount in Rs. Crores)

Agency		2019-20	2020-21
Co-operatives	Amount	1,57367	1,90,682
	Share (in %)	11.3	12.1
RRBs	Amount	1,65,326	1,90,012
	Share (in %)	11.9	12.1
Commercial Banks	Amount	10,7036	11,94,704
	Share (in %)	76.8	75.8
Total		13,92,729 (100%)	15,75,398

Source: Data from RBI and NABARD

Thus, it is observed from Table 5 that the long term credit given for financing investment by rural borrowers have increased manifold. Further, commercial banks have emerged as a major player in providing term- credit.

At present, there are 43 RRBs in India with 21,856 branches across 26 states and 3 UTs, They are sponsored by 12 scheduled commercial Banks (SCBs). RRBs in India have 28.3 crore depositors and 2.6 crore borrowers. There are 31 Co-operative banks ,1,00,428 are PACS/LAMPS/FSS and 619 SCARDB's and PCARDB's in rural India. Currently there are a total of 34 nationalised banks in India of which 12 are Indian Government banks and 22 are private sector banks. Total number of branches of all scheduled commercial banks increased from 8321 in year 1969 to 1,62,904 in year 2021. There are 1,57,868 total commercial bank branches in India, out of which 52,914 branches are serving in rural areas at the end of June 2021. There were 1,00,159 PACS/LAMPs/FSS as on 31st March 2021 with membership of 1,02157842 (10.22 cores).

Section III

Major Areas of concern of Rural Financial Institutions

Inspite of several innovative measures and satisfactory growth of rural credit system in India, it witnessed various deficiencies and weaknesses as well. Some of the major areas of concern are presented below:

- **Non-Viability**

All RFIs working in rural areas may it be co-operative banks, regional rural banks or commercial banks are incur huge losses. These are surviving, however, either with the help of state subsidies or with cross- subsidisation by their parent organisation. There are several reasons for non-viability of these rural credit institution such as inflexible management, mandatory lending and high rate of over-dues.

Table 6: Profitability of Rural Financial Institutions (As on 31st March 2021)

Co-operative Banks		In Profit	In loss
Short Term Co-operative Banks	PACS	47,297	6,37,419
	Amount	5,29,769	4,31,984
	DCBs	308	43
	Amount	2,0,067	66,884
	SCBs	32	2
	Amount	1,40,178	
Long Term Co-operative Banks	PCARDBs	311	292
	Amount	19251	66532
	SCARDBS. Net Profit/ Or Loss	627	-
	Accumulated losses	-	518
RRBs	Number	30	13
	Amount	3,550	1,867

Source : Compiled from data provided in Report on currency and Finance : RBI publication

The Government policy of directed credit with emphasis on quantitative targets has resulted, in all pervasive sickness in rural credit system in India. Implementation of government sponsored credit linked poverty alleviation programmers, with high transaction costs and default rate has affected the viability of RFIs. In order to be viable, RFIs should have sufficient margins between lending rates and cost and cost of funds raised for lending.

Table 7: NPA Recovery Performance of Rural Financial Institution

Institutions/Year		2020	2021
PCARDB's	NPA (% of loan outstanding)	43	44
	Recovery (% of demand)	47	42
	Total NPA	6773	6818
SCARDB's	NPA (% of loan outstanding)	33	332
	Recovery (% of demand)	43	46
SCBs	NPA (% of loan outstanding)	6.7	6.7
	Recovery (% of demand)	94.4	90.5
DCBs	NPA (% of loan outstanding)	12.6	11.4
	Recovery (% of demand)	70.2	74.9
RRBs	NPA (% of loan outstanding)	10.4	9.4
	Gross Amount	31.106	31.381

Source: Compiled from data provided in Report on currency and Finance : RBI publication

It has been observed in Table 7 that percentage of over-dues to demand was highest in PCARDBs. At the institutional level, build up of overdue has restricted the capacity of RFIs to recycle their funds and sustain the tempo of growth and also it has impaired eligibility of credit agencies in availing refinance facility from NABARD. This aspect has greater relevance in case of RRBs and co-operative banks which depend largely on NABARD for their lendable reserves.

Section IV

Conclusion and Suggestions

Considerable progress has been made in all the directions is which actions were initiated for development of the rural credit system. A huge network of outlets for granting credit has come into existence in rural areas, the spatial coverage has been satisfactory even. The most backward regions have obtained the facility of credit from organised sources. Credit advanced to agriculture and allied rural activity has increased phenomenally, small and marginal farms had their share in credit advanced by RFIs and credit institutions have started playing crucial role in rural development in India. One of the features of the formal credit system in India is the mainstream banking with an extensive network. There are several factors in favourable to formal RFIs in India such as multi-agency approach, vertically integrated structure, high density of field staff, multiple and diversified services, search of clientele, experienced staff, absence of start-up period etc. However, at the same time the main short coming are inadequate autonomy lesser attention to non-farm sector, lack of monitoring, political interference relatively high cost associated with the centrally planned credit system, low recovery rate of loans, lack of responsiveness and flexibility negative mind set of staff towards.

A strong consensus should be developed in favour of developing a viable rural credit system with long-term prospective, RFIs together with the apex institution i-e NABARD should create awareness about the urgency of viable rural credit system etc. Existence of high and persistent loan delinquency, politicisation and bureaucratisation and low resource efficiency are serious problems of RFIs (ACRC Report). However, the main concerns on two main objectives namely non- viability of RFIs and problem of high over dues which requires priority consideration and expeditions action. Apex level institution NABARD has to play a pro-active role for the revival of dormant and or non-viable primary level rural institutions for the rapid development specially the co-operatives. Promises of loan write-off from the political platform often generate the psychology of non-payment, thus vitiating the recovery climate everywhere. Commercial banks have introduced various schemes for social welfare and for upliftment of rural poor masses. They have done reasonably well in quantitative terms, however, they have been failed miserably in recycling of their funds they have lent. The concept of socialisation has also seriously eroded the profitability of commercial banks due to various reasons like rate of interest, long maturely period, less margins etc. There should be proper balancing between commercial and social objectives. It has been observed that the incidence of over-dues in the rural credit system major cause for eroding the financial scarcity of the system. There is an urgent need to check over-dues and non performing assets (NPAs) to improve recovery performance of RFIs. On discussing the problem of RFIs with some of the officials of NABARD and RFIs the following changes are considered imperative for the financial viability of the RFIs in India.

Suggestions for reducing over-dues/NPA and improving viability of rural credit system.

- Recovery of loans should be insisted upon during the harvesting season.
- lending institution should undertake case-to case analysis of over-dues.
- Review & monitoring for use of loans regularly.
- In case of chronic and high over-dues a time bound programme for recovery of loans should be followed.
- Documentation procedures should be simplified for illiterate borrowers.
- RFIs should help in marketing of their products. In some cases, RFI may enter into tripartite agreement with the borrower and the marketing channel, whereby payment will be made directly made to RFI after sale.
- Consumption loans should be provided only after taking into account the loan repaying capacity of the borrower.

- Majority of defaults in repayment of loans are wilful. Committing of suicide by poor farmers implies that small and poor farmers are honest and mischief of non-payment of dues is committed generally by big and wilful defaulters. Thus, the wilful defaulters should be dealt with sternly, promptly and effectively.
- Efforts should be made for greater mobilisation of savings to increase the volume of businesses. A study by world bank suggests that th rural poor still rely on non-institutional sources to a great extent as they have not yet developed banking habits.
- Necessary autonomy should be provided to RFIs in terms of granting credits.
- The outreach of formal banking system can be improved through formation/linkage of SHG/NGOs and introducing credit delivery innovations based on successful approach adopted in India and abroad.
- Loss incurring RFIs may operate as 'Narrow Bank', that is they may mobilise savings from rural areas and invest in government securities or high government securities or high income bearing and safe securities for same time to enhance their earnings until they reach to break-even point.
- Rural credit system in India should adopt itself to the changing business environment with a view to providing appropriate services to its clientele. Some of the suggestions for improvement are adoption of customer oriented banking procedures, further ease of transactions, change of rules and procedures to make them more transparent and easily understandable, simplified forms, special assistance to illiterate and semi-illiterate customers etc. Human Resource employed in the banks should be properly trained, accountable and most importantly have a rural orientation.

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