CHAPTER I

Introduction
1.0 INTRODUCTION

Agriculture is the first culture that man learnt to practice as a means of living and a way. However, with the advancement of knowledge, culture and civilization the place, pattern practices and potentialities of agriculture, have been continually undergoing a process of transformation. From a mere primitive way of life and a source of livelihood, it has come to be realised as a commercialised activity and profitable business proposition and a vital Instrument of progress. In India the vital role of agriculture arises out of the position the agrarian sector occupies in the overall economy of the country. Agriculture is the largest sector of the economic activity and has a crucial role to play in the country's economic development by providing food and raw material, employment to a very large proportion of population, capital for its own development and surpluses for the national economic development. Thus the importance of agriculture despite rapid industrialisation has not in any way diminished. It has become necessary not only to achieve self-sufficiency in matters of food and agricultural raw-material, but to highly modernise agriculture so as to throw up surpluses to be made available for investment for investment in the other sectors of economy as well.

The adoption of new technology has given rise to increasing demand for farm credit which is the key factor in, and life blood of agricultural development. The organisation of institutional credit is one of the major factors governing agricultural production particularly that of small and
marginal farmers. But, it is no wonder that all farmers especially small peasants, have to borrow at one time or other. The rural masses borrow almost habitually, passing on the burden of debt to the next generation. It is perhaps, this phenomenon of agriculture that compelled Nicholson to observe that "The lesson of universal agrarian history from Rome to Scotland is that an essential of agriculture is credit. Neither the condition of the nature of the land tenures, nor the position of agriculture, affects the one great fact that agriculturists must borrow". Agricultural credit, thus, in a practical sense, is a nucleus of the system of farm operations. It provides a flow to the system averting ruin which would have occurred due to the lack of monetary capacity of farmers. The Rural Credit Survey Report quotes the French proverb which says that, "credit supports the farmer as the hangman's rope supports the hanged". Adequate and timely credit to the farmer is, therefore, vital and indispensable for the rehabilitation and progress of agriculture.

The bulk of the loans for agriculture in the developing countries originates in the informal sector and probably is not less than five times the outstanding of institutional credit. The percentage of farmers receiving institutional credit varies widely in different parts of the developing world. Imperfections in the agricultural credit market are ubiquitous and more pronounced. Large farmers have been the main beneficiaries of institutional credit. It is common to find 70 to 80 percent of small farmers in the developing world with virtually no access to such credit. Further, the supply of credit among different categories of farmers in heavily skewed,
institutionalisation of agricultural credit is usually necessary, through not sufficient, condition for an increase in agricultural productivity and incomes. This applies especially to small farmers who have neither savings nor ready access to institutional sources. The policy makers in almost all developing countries have realised the role of institutional credit in agricultural and rural development.

1.1 DEMANDS FOR AGRICULTURAL CREDIT

Credit is the temporary transfer of purchasing power. It is the external source of capital for investment. There is a strong, though often latent, demand for agricultural credit in the developing world. It must be stressed that credit, though often necessary, is only one instrument for promoting agricultural development. In general, the demand for credit depends on the level of economic development of a country and the structure of its agricultural economy².

Provision of adequate institutional credit to support the modern technology, and augmentation of agricultural productivity and production is the basic aim of the country's agricultural credit policy³. All production activities require for their sustenance some degree of credit, the amount and duration of which depends on the length of the production cycle⁴. So all rural families engaged in production activities need to save some at one time and may borrow at other times. Financial institutions in this regard can help the potential savers and borrow at other times. Financial institutions in this regard
can help the potential savers and borrowers by adjusting to their different behavior and this process will increase the community's investments and productivity\textsuperscript{7}. Credit could play a major role in preventing the rather extreme measures of asset depletion and pauperisation adopted by the farmers in drought years\textsuperscript{8}. Removal of regional imbalances in the matter of credit supply is another important objective which is receiving attention from the government.

The programme for achieving higher levels of productivity and production calls for a marked increase in the volume of both production and investment credit with a large share going to the weaker sections and backward areas. As the majority of the farmers in the country are small and marginal farmers have meager resources, there is a need for such credit policies and programmes as would enable them to make step-by-step progress towards scientific and intensive use of their limited land resources by a greater input of both labour and capital\textsuperscript{9}. To facilitate understanding of the credit needs of the farmers, it would be fruitful to break up the total demand for credit of cultivator households for major purposes. The basic purposes for which farmers borrow have been classified into four types of credit and the classification is explained below.

1.2 CLASSIFICATION OF AGRICULTURAL CREDIT

Generally, credit for agriculture is available as direct credit and indirect credit. In the direct credit, finance is provided directly to the farmers for
productive purposes such as crop production, land development, irrigation, purchase of implements, machinery, equipment, development of agricultural allied activities like dairy, sheep rearing, poultry, fisheries, development of plantations like tea, coffee, rubber, coconut, cashew nut, etc., While in the indirect credit, finance is provided through the institutions involved in the supply of production inputs and other relative services of agriculture. Agricultural credit can be classified into indifferent ways as per the requirement and period of credit granted. The classification of agricultural credit is presented in Chart 1.1.

**Chart 1.1**

**Classification of Agricultural Credit**

- Period-wise
- Purpose-wise
- Security-wise
- Creditor-wise

1. Short-term
2. Medium-term
3. Long-term

1. Farm
2. Non-farm
3. Family expenditure

1. Secured
2. Un-secured
1. Institutional
2. Non-institutional

**A. PERIOD – WISE CLASSIFICATION**

Period or duration is an important basis for classification of agricultural credit. Based on the period, credit needs of the farmers may be classified as short-term, medium-term and long-term credit.
(i) Short-Term Credit

Short-term or seasonal credit is that which is granted for the purpose of providing working capital requirements of the farmers. Generally, farmers are required to run their farms efficiently to obtain crop in the best possible manner. They hold credit up to the sale of harvest. The period for which this type of credit is provided generally ranges from 6 months to 15 months or it can exceed more. According to the All India Rural Credit Review Committee, the short-term credit is lumpsum credit facility which is provided to fill up the gap in outlay which cannot be met by the own resources of farmers during the period between two harvests. The various purposes for which short-term credit is provided are: purchases of seeds/ fertilizers / insecticides, hiring of labour, hire charges of agricultural machineries, payments of electricity bills, tax on land, godown charges etc. These loans are disbursed through Primary Agricultural Credit Societies, Commercial Banks and Regional Rural Banks. In such case, the security is accepted in the form of anticipated crop production and credit is provided accordingly. While the consumption loans sanctioned on the basis of personal security of the borrowers.

(ii) Medium-term Credit

Medium term Credit is provided to the farmers for the purposes like land development, purchase of implements, machinery, livestock, conversion of cultivation system etc... This credit is provided for more than 15 months but not exceeding 5 years. The medium-term credit is classified into two
categories. The first category belongs to maintenance or replacement of existing production assets i.e., normal credit requirements, while the second classification is concerned with new investment for improving the productive efficiency of the farm i.e, special medium-term loans. The medium-term credit are repaid in half-yearly or annual installments.

(iii) Long-Term Credit

Generally, farmers require all types of credit at various stages of farming. But the need for long-term finance is more pressing. As stand by the RBI in its preliminary reports, long-term credit is more important and if any effective steps are taken to make the agriculturist credit-worthy, this is the first problem which is to be tackled. The long-term loans are granted for a period of more than 5 years and upto 10 years. In some cases, it may be granted for a period upto 20 years. Various uses of long-term loans are purchase of farm or buying of additional land, construction of buildings for farm operations, provision of drainage, reclamation of land and other improvements. The long-term loans are re-paid in annual installments.

B. PURPOSE-WISE CLASSIFICATION

According to the Reserve Bank's classification agricultural credit may be classified into three types viz., credit for farm activities, credit for non-farm activities and credit for family expenditure.
(i) Farm credit

This type of credit is provided for purchase of seeds, fertilizers, insecticides, hiring of labour, land improvements by irrigation and drainage, purchase of agricultural implements, machinery and livestock, construction of farm houses, cattle sheds, tanks and embankments, laying of orchards etc. In other words, this credit is provided to support the working capital expenses on farm business.

(ii) Non-farm Credit

Such credit is provided to meet the working capital expenses on non-farm business such as repair of production and transport equipment and furniture, purchase / construction and repair of buildings, purchase of non-farm equipment etc.,

(iii) Credit for Family Expenditure

Such credit is required to meet the household expenditure like clothing, education, medicines, expenses regarding marriages, death ceremonies and other social events in family, irrigation and payment of old debts etc. Though these types of loans are meant for personal purpose, the cultivators may borrow by showing the agricultural deeds and are repaid after selling of their produce.

C. SECURITY-WISE CLASSIFICATION

According to this type of classification, the agricultural credit may be categorised as secured credit un-secured credit. It is based on the type of security offered by the farmer while obtaining the credit.
(i) Secured Credit

It is also known as 'Farm Mortgage Credit and Chalttel or Collateral Credit'. In this type, credit is available against the pledge of some tangible property of the borrower. In fact, borrowers offer livestock, produced items, warehouse receipts, shares, bonds, and insurance policies etc., as securities.

(ii) Un-secured Credit

Un-secured credit is granted on personal security of the borrower. It is provided on the promissory or personal notes of the borrower with or without another guarantee. Naturally, loans of this type are available through informal sectors such as moneylenders.

D. CREDITOR–WISE CLASSIFICATION

The agricultural credit may be classified on the basis of creditor also. There are two main sources of credit viz., institutional and non – institutional credit.

1.3 SUPPLY OF CREDIT

The present system of agricultural credit in India is supplied through a plurality of agencies usually termed as institutional and non-institutional. The non-institutional sector consists mainly of the landlords, professional and agricultural moneylenders, commission agents, traders, relatives and friends etc. The institutional sector mainly comprise of Co-operatives, Commercial Banks, Regional Rural Banks and government. 

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1.4 ROLE OF NON-INSTITUTIONAL AGENCIES

Informal finance and self finance prevail beyond the frontier of the formal financial system. Informal finance consists of borrowing and lending among individuals and firms that are not registered with the government as financial intermediaries and are not subject to government supervision. Informal finance is tremendously diverse and is generally conducted within border relationships, starting from kinship and extending outward to friendship and customary social bonds and beyond to include credit associated with commercial transactions and land tenure arrangements\(^{16}\). It is very difficult to give a clear cut logical definition of the sector, which is better identified by its dominant characteristics such as ease of entry and exist in formality of transactions and smallness of scale\(^{17}\).

(i) Empirical Evidence

The All India Rural Credit Survey classified the moneylenders into two major categories, namely professional and agricultural moneylenders. The moneylenders accounted for 70 per cent of the rural credit in 1951-52. But this percentage fell to 36 per cent in 1971, 16.1 per cent in 1981 and only 7 percent in 1995-96. This clearly shows that moneylenders share in the supply of rural credit has been diminishing. About 10 per cent of the village moneylenders were non cultivation landlords. So landlords cannot be separated from moneylenders and vice versa\(^{18}\). Moneylenders will become landlords slowly because of one reason or other. The share of landlords in
agricultural credit was 1.5 percent in 1951, 8.8 percent in 1981 and 10 percent in 1995-96. The traders who live in village generally advance short-term loans to the agriculturists. Majority of the farmers who borrow from them make voluntary arrangements to sell their produce through traders. With the establishment of market yards and marketing system, the importance of traders is slowly coming down. The share of traders in farm credit was 5.5 percent in 1951, 8.7 percent in 1981 and only 3 percent in 1995-96.

(ii) Empirical Evidence: Studies by Individual Researchers

Karam Singh surveyed seven lenders in a village in Amritsar District in northern India and estimated using linear programming analysis. The monopoly profits approximated 9 percent of amounts loaned, while interest rates paid by borrowers exceeded 140 percent per annum\textsuperscript{19}. One lender in his sample suffered a net loss during the period reviewed. More than half of the staggering rate to borrowers reflected the opportunity cost of capital in the village and about one quarter was contributed by the risk premium.

Barbara Hariss\textsuperscript{20} studied rural markets in north Arcot District in southern India. She found a competitive market with links between formal and informal finance, a general lack of predatory credit relationship and little opportunity for monopoly profits. She noted the speed and convenience with which traders deliver informal credit, competition among traders that resulted in zero interest paddy loans, slow repayment by some borrowers, complete failure to repay traders by about 5 percent of borrowers and interest rate that increased with the length of time for which credit is outstanding.
Farrukh Iqbal applied econometric techniques to analyse interest rates in formal and informal financial market in India using data collected from 2,912 farm households between 1971 and 1988 by the National Council of Applied Economic Research. He compared rural interest rates with levels of agricultural technology. His results indicate that improvements in agricultural technology go together with reductions in the moneylenders interest rate. He further noted that improvement in technology tend to decrease risk, at least over a period of a few years or more. Iqbal’s analysis suggests that moneylenders costs, especially those associated with risk, are reflected in their lending rates. He found that moneylenders’ rates appear to be sensitive to many other variables relating to the status of the borrower, risk and productivity and to competition from formal lenders. His results provide strong indications that the market is competitive, leaving relatively little space for monopolistic practices such as exploitive interest rates. Iqbal concluded that “the monopoly surcharges while not insignificant is found to be low”.

Thomas, A.Timburg and C.V. Aiyar surveyed 1000 persons involved in informal finance in urban markets in India to explore relationships between traders, shopkeepers, restaurateurs, other businessmen and the indigenous bankers who were their creditors”. They concluded that informal lenders were efficient commercially and that their activities produced a higher level of intermediation for the economy overall and an increase in savings and productive investment. They could find no marked negative results such as monopoly profits in the informal commercial credit market.
Non-institutional credit continues to play an important role and all of it need not be unwelcome. Majority of agriculturists continue to seek loans from informal agencies because they are easily accessible and flexible. Considering the enormity of the problem, the total demand for credit, supply from the institutional agencies, and the role of non-institutions will continue to be important for quite some time.

1.5 INSTITUTIONALISATION OF AGRICULTURAL CREDIT

There has been a phenomenal progress in the institutionalisation of agricultural credit during the period from 1971 to 2006. The institutional structure for agricultural credit is presented in chart 1.2.

The problem of agricultural finance in India like that of the other developing countries is both quantitative and qualitative. It is colossal from the stand point of credit requirements and inadequate and serious from the stand point of agencies supplying credit. The report of the All India Rural Credit Survey Committee brought into sharp focus the inadequacy of co-operative finance to agriculture. The Rural Debt and investment Survey underlined the changes in the pattern, quantity and texture of farm credit arising out of the measures initiated on the basis of the prescription of the survey report. The decades 1961-71, 1971-1981 and 1981-1991 had been colourful, revolutionary and more promising when compared to the decade 1951-61. Not only the sphere of institutional credit further strengthened, but the quantum and methods of financing agriculture also underwent incredible changes. The changing scenario of Indian Agricultural Credit in the course of five decades is shown in Table 1.1.
Chart 1.2
Institutional Arrangements for Rural Credit in India

Government of India  NABARD  Reserve Bank of India

Co-operative Bank

Commercial Banks

Metropolitan branches (7333)

Urban branches (9025)

Semi-urban branches

Short-term structure

Long-Term Structure

DCCBs (361)  SLDB Branches (NA)

PACCS (91000)  PLDBs

RRBS (196)  RRB Branches (14509)

Depositors
And
Borrowers

Note: Figures in brackets indicate number of officers

Abbreviations:

NABARD: National Bank for Agricultural and Rural Development

SCBs: State Co-Operative Banks

DCCBS: District Central Cooperative Banks

PACS: Primary Agricultural Credit Societies
SLDBs : State / Central Cooperative Land Development Banks

PLDBs : Primary Co-operative Land Development Banks


The structure of agricultural credit revealed by the fore-going table confirms the grip of non-institutional sources in 1971 and institutional sources in 1981. We can observe the clear hold of institutional sources by 1995-96. The share of institutional sources which was merely 7.3 in 1951 increased to 31.7 per cent in 1971 and increased further to 75 per cent in 1995-96. But by 2005-06 again the share of institutional credit sources started declining and its share came down to 61.1 per cent in 2005-06 from 75 per cent in 1995-96. Among institutional sources co-operative societies share is very high. It is 30 per cent, followed by 28 per cent by commercial banks and 5 per cent by the government. We can observe a tremendous increase in the share of co-operative banks which increase to 40 per cent in 1995-96 from only 3.3 per cent in 1951-52.

The share of non-institutional sources is decreasing drastically. It was very high at 92.7 in 1951-52 but sharply declined to 36.8 per cent in 1981-82 and further to only 25 per cent in 1995-96. But its share started increasing after 1995-96 and reached 38.9 per cent by 2005-06. Among non-institutional sources moneylenders were playing an important role with almost 70 percent share. But gradually its share declined to 16 per cent in 1981-82 and only 7 per cent in 1995-96. But by 2005-06 the share of moneylenders increased

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again to 26.8 per cent in the year 2005-06. The share of traders is almost same for the observed years. The per cent of credit offered by landlords and others alone recorded a slight uptrend among all non-institutional sources. The share of landlords and others increased to 10 per cent in 1995-96 from mere 3.3 per cent in 1951-52, but declined to 5.4 percent by 2005-2006. Agricultural credit structure is presented in diagram 1.1.
## Table 1.1

Borrowing of Cultivators from Different Credit Agencies

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Credit Agency</th>
<th>Proportion in Total Borrowings in per cent</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>Institutional Credit (1 to 3)</td>
<td>7.3</td>
</tr>
<tr>
<td>1</td>
<td>Government Society / Banks</td>
<td>3.1</td>
</tr>
<tr>
<td>2</td>
<td>Co-operative Society / Banks</td>
<td>3.3</td>
</tr>
<tr>
<td>3</td>
<td>Commercial Banks &amp; Rural Banks</td>
<td>0.9</td>
</tr>
<tr>
<td>B</td>
<td>Non-Institutional Credit (4 to 7)</td>
<td>92.7</td>
</tr>
<tr>
<td>4</td>
<td>Moneylenders</td>
<td>69.7</td>
</tr>
<tr>
<td>5</td>
<td>Traders</td>
<td>5.5</td>
</tr>
<tr>
<td>6</td>
<td>Relatives and Friends</td>
<td>14.2</td>
</tr>
<tr>
<td>7</td>
<td>Landlords and others</td>
<td>3.3</td>
</tr>
<tr>
<td></td>
<td>Total (A+B)</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Source: 1. All India Credit and Investment Survey, 1961-62.
DIAGRAM 1.1
Agricultural Credit Structure in India

- Institutional Credit (1-3)
- Non-Institutional Credit (4-7)
1.6 PROGRESS OF INSTITUTIONAL CREDIT IN INDIA

Among the institutional agencies, co-operatives are the single largest agency providing credit since in inception. Co-operatives as purveyors of rural credit have come to occupy a predominant place among the institutional agencies. After nationalisation of commercial banks and inception of Regional Rural Banks, the participation of banks in agricultural credit entered into new phase. The progress of institutional credit for agriculture is presented in Table 1.2

It is observed from the Table 1.2 that the increase of institutional credit is impressive. The participation of commercial banks in farm financing increased by 16.77 times and that of co-operatives 9.31 times. The credit issued by RRBs increased from Rs.596 crore in 1991-92 to Rs.20,228 crore in 1996-97. The total institutional credit issued for agriculture increased from Rs.11538 crore in 1991-02 to 1,44,02 crore in 1995-96, registering 12.48 times increase during the period. The growth in the disbursement of loans by institutional credit sources over the period of time is represented graphically in Diagram 1.2.
### Table 1.2

Disbursement of Institutional Credit for Agriculture Loans
Issued From 1991-92 To 2006-07

(Rs. In Crore)

<table>
<thead>
<tr>
<th>Year</th>
<th>Co-operatives</th>
<th>Commercial Banks</th>
<th>Regional Rural Banks</th>
<th>Government</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991-92</td>
<td>5797</td>
<td>4806</td>
<td>596</td>
<td>339</td>
<td>11538</td>
</tr>
<tr>
<td>1992-93</td>
<td>6484</td>
<td>4960</td>
<td>698</td>
<td>389</td>
<td>12530</td>
</tr>
<tr>
<td>1993-94</td>
<td>8484</td>
<td>5400</td>
<td>752</td>
<td>377</td>
<td>15013</td>
</tr>
<tr>
<td>1994-95</td>
<td>9876</td>
<td>7408</td>
<td>1083</td>
<td>407</td>
<td>18773</td>
</tr>
<tr>
<td>1995-96</td>
<td>12483</td>
<td>9274</td>
<td>1381</td>
<td>554</td>
<td>23692</td>
</tr>
<tr>
<td>1996-97</td>
<td>13254</td>
<td>10675</td>
<td>1748</td>
<td>668</td>
<td>26345</td>
</tr>
<tr>
<td>1997-98</td>
<td>14159</td>
<td>11537</td>
<td>2103</td>
<td>858</td>
<td>28656</td>
</tr>
<tr>
<td>1998-99</td>
<td>15099</td>
<td>14663</td>
<td>2515</td>
<td>420</td>
<td>32697</td>
</tr>
<tr>
<td>1999-00</td>
<td>25678</td>
<td>16350</td>
<td>2985</td>
<td>520</td>
<td>45534</td>
</tr>
<tr>
<td>2000-01</td>
<td>27295</td>
<td>16440</td>
<td>3966</td>
<td>487</td>
<td>48187</td>
</tr>
<tr>
<td>2001-02</td>
<td>30569</td>
<td>18638</td>
<td>4546</td>
<td>443</td>
<td>54195</td>
</tr>
<tr>
<td>2002-03</td>
<td>34040</td>
<td>25256</td>
<td>5879</td>
<td>-</td>
<td>65175</td>
</tr>
<tr>
<td>2003-04</td>
<td>40049</td>
<td>36203</td>
<td>7175</td>
<td>-</td>
<td>83427</td>
</tr>
<tr>
<td>2004-05</td>
<td>45009</td>
<td>48367</td>
<td>11927</td>
<td>-</td>
<td>105303</td>
</tr>
<tr>
<td>2005-06</td>
<td>48123</td>
<td>80599</td>
<td>15300</td>
<td>-</td>
<td>144021</td>
</tr>
<tr>
<td>2006-07</td>
<td>54019</td>
<td>-</td>
<td>20228</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>

Source: RBI, Report on Currency and Finance (various issues)
Diagram 1.2
Growth in Disbursement of Loans by Institutional Sources
A. Co-Operatives

The Indian Co-operative Act was passed during the dawn of past century in 1904 by the Imperial council to provide credit facilities to the farmers and eradicate the rural indebtedness which was very common throughout the country during that period. Since then the credit through co-operative is flourishing in the country, but during pre-independence period its progress was very slow and it gained momentum after independence. Co-operative credit societies have made commendable progress especially in the processing.

The co-operative banking structure is pyramidal in the character. There are primary agricultural credit societies at village level upon which the entire edifice of co-operative finance is based. These societies are federated at district level into “Central Co-operative Banks” and at state level “Apex Bank”. The Apex or State Co-operative Bank in its turn is closely linked with NABARD which provides considerable financial assistance to co-operative credit structure. The loan is to advance from State Co-operative Banks to Central Co-operative Banks at district level and from them to Primary Agricultural Credit Societies which ultimately provide credit to the farmers. The structure of Co-operative societies in India is shown in Chart 1.3.

There is a separate institutional arrangement for providing long-term agricultural credit. Such loans are granted by Central land Development
Banks at the state level and their affiliated Primary Land Development Banks at lower levels. After the adoption of the multi-agency approach in agricultural lending and the entry of commercial banks in the field in a big way, the performance of Land Development Banks has shown a declining trend in respect of their share in agricultural lending. The progress of co-operative movement in India is presented in table 1.4.
CHART 1.3
STRUCTURE OF CO-OPERATIVE INSTITUTIONS

Co-operative Credit Institutions

Urban Co-operative Banks (1,853)

Scheduled (UBSAs 55)

Multi State (24)

Multi State (10)

Operating in Single State (31)

Operating Single (1788)

Non-scheduled UBSAs (1,798)

Rural Co-operative Credit Institutions (1,09,834)

Short term (1,06,117)

Long term (747)

State Co-operative Banks (31)

District Central Co-operative Banks (26)

Primary Agricultural Credit - Societies (1,04,779)

SCARDBs (20)

PCARDBs (727)

SCARDBs : State Co-operative and Rural Development Banks
PCARDBs : Primary Co-operative and Rural Development Banks
Note : Figures in brackets indicates the number of institutions at end-March 2008 for UBSAs and at end-March 2006 for rural co-operative credit societies.
Source : RBI, Report on Trend and Progress of Banking in India, 2005-06, page: 126
Table 1.3
Profile of Co-operative Credit Banks
(As at 31st March 2007)
(Rs. in Crores)

<table>
<thead>
<tr>
<th>Item</th>
<th>Short-Term</th>
<th>Long-Term</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>StCBS</td>
<td>DBCBs</td>
<td>PACS</td>
</tr>
<tr>
<td>Number of Co-operative Banks</td>
<td>31</td>
<td>371</td>
<td>97224</td>
</tr>
<tr>
<td>Owned Fund (Capital + Reserves) Rs.</td>
<td>10549</td>
<td>26180</td>
<td>11038</td>
</tr>
<tr>
<td>Deposits Rs.</td>
<td>48560</td>
<td>94529</td>
<td>23484</td>
</tr>
<tr>
<td>Borrowings Rs.</td>
<td>22256</td>
<td>29912</td>
<td>43715</td>
</tr>
<tr>
<td>Loans and Advances Issued Rs.</td>
<td>52777</td>
<td>82963</td>
<td>49614</td>
</tr>
<tr>
<td>Loans and Advances Outstanding Rs.</td>
<td>47354</td>
<td>89038</td>
<td>58620</td>
</tr>
<tr>
<td>Total Loans Overdue Rs.</td>
<td>6704</td>
<td>16495</td>
<td>11558</td>
</tr>
<tr>
<td>As percentage of Loans Outstanding</td>
<td>14.2</td>
<td>18.5</td>
<td>2639</td>
</tr>
<tr>
<td>Recovery of Loans to Demand (per cent) (as on 30 June)</td>
<td>85.7</td>
<td>71.1</td>
<td>70.9</td>
</tr>
</tbody>
</table>

Table 1.3 shows the financial profile of various co-operative banks for the year 2006-2007. Total number of co-operatives at different levels in the year was 98348, in which PACs at village level occupy almost 99 per cent followed by PACARDBs and DCCBs. Owned fund of all banks was Rs.54294 crore. All co-operative banks accepted deposits upto Rs.167519 crores and borrow funds from different sources to the tune of Rs.125296 crores. Total amount sanctioned as loans by all co-operatives was around Rs.1,89,759 crores and outstanding amount was Rs.2,25,770 crores. State co-operative banks had very high rate of recovery of overdues. It was around 85 per cent.

B. Commercial Banks

With the breakthrough in farm technology, agriculture has become increasingly capital intensive. As the majority of farmers in this country are poor, they are unable to meet their increased farm financial requirements from their own funds. Thus, the new technology is largely responsible for contributing a big spurt in the demand for production and investment credit. Although co-operatives were in the field for more than seven decades, they could not meet the vast and expanding credit needs of farming. With the nationalization of fourteen major commercial banks on 19th July 1969, the flow of banks credit was diverted to agriculture as well. Since then commercial banks have been intensively financing the farmers in order to fulfill their production as well as investment credit23. The structure of commercial banking system in India is presented in chart 1.4.
After banks nationalisation, commercial banks came forward to lend credit in a big way to the priority sector. Apart from the general emphasis on lending to the primary sector, targets were also fixed by RBI in the form of proportion of lending to priority sector and credit deposit ratio. Firstly, commercial banks share to the priority sector should reach a level of 47 per cent of outstanding credit by March 2008.

![Chart 1.4: Structure Of Commercial Banking in India]

Source: RBI, Report on Trend and Progress of Banking in India, 2007-08

Commercial Banks – Financing Agriculture

The credit flow of both Public and Private commercial banks for priority sector in different time periods can be observed in table 1.5.
Table 1.4
Agriculture and Priority Sector Credit by Commercial Banks

(Rs. in Crores)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total credit</td>
<td>26551</td>
<td>117723</td>
<td>168836</td>
<td>946590</td>
<td>1709015</td>
</tr>
<tr>
<td>Priority sector credit</td>
<td>9444</td>
<td>42880</td>
<td>61794</td>
<td>381476</td>
<td>772186</td>
</tr>
<tr>
<td>Agricultural sector credit</td>
<td>4160</td>
<td>16756</td>
<td>23468</td>
<td>125250</td>
<td>306387</td>
</tr>
<tr>
<td>Share of priority sector credit to total credit (%)</td>
<td>35.9</td>
<td>36.4</td>
<td>36.6</td>
<td>40.3</td>
<td>45.2</td>
</tr>
<tr>
<td>Share of agricultural sector credit to total credit (%)</td>
<td>15.7</td>
<td>14.2</td>
<td>13.9</td>
<td>13.2</td>
<td>17.9</td>
</tr>
</tbody>
</table>

Source: RBI, Report on Trend and Progress of Banking in India, various issues.

From the table 1.4 it is evident that commercial banks lending to priority sector and agriculture has been increasing over the period. In the year 1981 total credit flow from commercial banks was Rs.26,551 crore in which priority sector get Rs.9444 crore i.e., 35.9 per cent of total commercial bank credit. Among priority sectors, agriculture alone received Rs.4160 crore (15.7 per cent of total credit). Priority sector and agricultural sector's share is increasing continuously and in the year 2008 Rs.772,186 crore of credit in the total Rs.1709015 of commercial banks has been issued to priority sector which is around 45.2 per cent. Among priority sectors, the share of agriculture also increased to Rs.306387 crore i.e., nearly 17.9 per cent of the total commercial bank lending. The direct and indirect finance by commercial banks to agricultural sector from 1990-91 to 2007 is shown in the table 1.5.
### Table 1.5
Scheduled Commercial Banks Advances to Agriculture
(Rs. In Crores)

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Direct Finance</th>
<th>Indirect Finance</th>
<th>Total Direct &amp; Indirect Finance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Distribution of fertilizers and other inputs</td>
<td>Loans to Electricity boards</td>
</tr>
<tr>
<td>1990-91</td>
<td>16145</td>
<td>329</td>
<td>363</td>
</tr>
<tr>
<td>1991-92</td>
<td>17397</td>
<td>241</td>
<td>655</td>
</tr>
<tr>
<td>1992-93</td>
<td>18949</td>
<td>268</td>
<td>708</td>
</tr>
<tr>
<td>1993-94</td>
<td>19465</td>
<td>364</td>
<td>896</td>
</tr>
<tr>
<td>1994-95</td>
<td>21334</td>
<td>536</td>
<td>1165</td>
</tr>
<tr>
<td>1995-96</td>
<td>23814</td>
<td>756</td>
<td>1058</td>
</tr>
<tr>
<td>1996-97</td>
<td>27448</td>
<td>968</td>
<td>1233</td>
</tr>
<tr>
<td>1997-98</td>
<td>29443</td>
<td>1200</td>
<td>1417</td>
</tr>
<tr>
<td>1998-99</td>
<td>33094</td>
<td>1491</td>
<td>1627</td>
</tr>
<tr>
<td>1999-00</td>
<td>36466</td>
<td>1675</td>
<td>1723</td>
</tr>
<tr>
<td>2000-01</td>
<td>40485</td>
<td>2304</td>
<td>1697</td>
</tr>
<tr>
<td>2001-02</td>
<td>46581</td>
<td>3303</td>
<td>1841</td>
</tr>
<tr>
<td>2002-03</td>
<td>56857</td>
<td>3241</td>
<td>2966</td>
</tr>
<tr>
<td>2003-04</td>
<td>70781</td>
<td>4118</td>
<td>3533</td>
</tr>
<tr>
<td>2004-05</td>
<td>95565</td>
<td>5134</td>
<td>4174</td>
</tr>
<tr>
<td>2005-06</td>
<td>134798</td>
<td>6440</td>
<td>6464</td>
</tr>
<tr>
<td>2006-07</td>
<td>172128</td>
<td>8516</td>
<td>11319</td>
</tr>
</tbody>
</table>

Source: RBI Bulletin, various issues

RBI Report on Currency and Banking in India various issues.

Table 1.5 shows the direct and indirect credit provided by commercial banks to the agricultural sector. In the year 1990-91, commercial banks provided Rs.17334 crore of total credit in which direct credit accounted for
93.14 per cent. Direct credit by the commercial banks as well as total credit is increasing over the period of time. In the year 2006-2007, agricultural sector received Rs.1,72,128 crore of direct credit and Rs.82,564 crore of indirect credit from the commercial banks. Totally Rs.254692 crore of credit is provided by the commercial bank to the agricultural sector.

Agricultural Development Under the Five Year Plans

Indian agriculture was in a depressed and deplorable condition. Farmers were in heavy debt to the professional moneylenders and agricultural moneylenders. They had neither the money nor the knowledge to use proper equipment, good seeds and chemical manures. Mostly, agriculture was dependent upon rainfall and the vagaries of the monsoons. Productivity of land as well as labour had been declining and was the lowest in the world. Though 70 per cent of the working population was engaged in cultivation, the country depended heavily on imports of food grains to satisfy the minimum requirements of the people. This was the challenge when India launched the first five year plan.

Agricultural performance during the five year plans is presented in Table 1.6.
Table 1.6
Share of Agricultural Sector to the Total Plan Outlay, Targets, Actual Production of Food Grains and Growth Rates

<table>
<thead>
<tr>
<th>S. No.</th>
<th>Five Year Plan</th>
<th>Total Plan outlay (Rs. crores)</th>
<th>Total plan outlay to agriculture &amp; allied activities (Rs. crores)</th>
<th>Percent of total outlay</th>
<th>Food-grains targets (M.T)</th>
<th>Food-grains achievements (M.T)</th>
<th>Growth rates</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>First Plan 1951-56</td>
<td>1,960</td>
<td>600</td>
<td>31</td>
<td>162.6</td>
<td>66.9</td>
<td>4.2</td>
</tr>
<tr>
<td>2.</td>
<td>Second plan 1956-61</td>
<td>4,600</td>
<td>950</td>
<td>20.4</td>
<td>81.8</td>
<td>82.0</td>
<td>3.1</td>
</tr>
<tr>
<td>3.</td>
<td>Third plan 1961-66</td>
<td>8,600</td>
<td>1,750</td>
<td>20</td>
<td>101.6</td>
<td>72.3</td>
<td>3.3</td>
</tr>
<tr>
<td>4.</td>
<td>Fourth plan 1969-74</td>
<td>16,160</td>
<td>3,300</td>
<td>21</td>
<td>129.0</td>
<td>103.6</td>
<td>2.2</td>
</tr>
<tr>
<td>5.</td>
<td>Fifth plan 1974-79</td>
<td>39,300</td>
<td>8,080</td>
<td>21</td>
<td>125.0</td>
<td>131.9</td>
<td>4.2</td>
</tr>
<tr>
<td>6.</td>
<td>Sixth plan 1980-85</td>
<td>97,500</td>
<td>24,700</td>
<td>25</td>
<td>153.6</td>
<td>150.0</td>
<td>5.2</td>
</tr>
<tr>
<td>7.</td>
<td>Seventh plan 1985-90</td>
<td>1,80,000</td>
<td>29,770</td>
<td>22</td>
<td>175.0</td>
<td>171.0</td>
<td>3.13</td>
</tr>
<tr>
<td>8.</td>
<td>Eight plan 1992-97</td>
<td>3,61,000</td>
<td>52,000</td>
<td>14</td>
<td>183.0</td>
<td>176.7</td>
<td>3.9</td>
</tr>
<tr>
<td>9.</td>
<td>Ninth plan 1997-2002</td>
<td>8,59,000</td>
<td>1,66,583</td>
<td>19.39</td>
<td>191.2</td>
<td>189.4</td>
<td>4.1</td>
</tr>
<tr>
<td>10.</td>
<td>Tenth plan 2002-2007</td>
<td>15,25,000</td>
<td>3,05,055</td>
<td>20</td>
<td>199.8</td>
<td>192.6</td>
<td>N.A</td>
</tr>
</tbody>
</table>

2. Compiled from Indian agricultural in brief and economic Survey.

First Five Year Plan (1951-56)

The first five year plan was an attempt rehabilitate the war-torn economy of India. It did not accord priority to the development of agriculture and economic development. The outlay of agriculture was Rs.600 crore. It came to 31 per cent of the total outlay of the first five year plan period. There
was a remarkable achievement in food grain production i.e. 66.9 per cent during this plan period. The planning efforts brought 5.1 million hectares of land under irrigation and reclaimed 1.1 million hectares. The output of all agricultural commodities went up by 2.2 per cent giving a growth rate of 4.2 per cent. The factors responsible for increased agricultural products were improved irrigation facilitates, use of fertilizers, land development and the extension of area under cultivation.

Second Five Year Plan (1956-61)

The outlay of agriculture in the second plan was Rs. 950 crore. It was 20 per cent of the total plan outlay. During this plan the main emphasis was on rapid industrialisation with a special accent on the development of basic and key industries. However, about 5.8 million hectares of additional land were irrigated during this plan period. The target of food grains production was 81.8 million tonnes. The achievement of food grains production was 82.0 million tonnes, which was higher than the target of food grains production. The growth rate was 3.1 per cent.

Third Five Year Plan (1961-66)

Achieving self-sufficiency in food grains was the major objective of the third five year plan. During this plan Rs. 1750 crore were allotted to agricultural sector. It is 20 per cent of the total outlay. In this plan government of India introduced the Intensive Agricultural District Programme (I.A.D.P.). The third plan aimed at raising overall agricultural production by 30 per cent. The food grains production was 72.3 million tonnes. The growth rate was 3.3 per cent.
Fourth Five Year Plan (1969-74)

The fourth five year plan emphasized the necessity to create additional infrastructure facilities for the promotion of agriculture and to make use of Science and Technology for this purpose. The planning commission adopted a "yield increase strategy", through the introduction of intensive agricultural production techniques. During this plan Rs. 3300 crore were spent for agricultural purpose, which was 21 per cent of the total outlay. The achievement of food grains was 103.6 million tonnes. The growth rate was 2.2 per cent in this plan.

Fifth Five Year Plan (1974-79)

In the fifth five year plan the amount allotted to agriculture sector was Rs.8080 crore which was 21 per cent of the total outlay. There was a steady increase in the use of agricultural inputs in this plan. The food grains production achievement was 131.9 million tonnes. The achievement was higher than the target of 125 million tonnes. The growth rate was 4.2 per cent.

Sixth Five Year Plan (1980-85)

The sixth five year plan aimed at marketing, trade and the institutional framework to develop agriculture. The amount spent during this plan was Rs.24,700 crore on agriculture and allied activities. This amount was 25 per cent of the total outlay. In this plan three programmes were introduced to help small and marginal farmers. They were: i) improving productivity and income from small holdings. ii) promoting and helping small farmers in organizing
their own storage and marketing facilities and iii) diversifying the earning opportunity of the rural poor through the Integrated Rural Development Programme (I.R.D.P.) and the National Rural Employment Programme (N.R.E.P.). The agriculture output grew at a steady rate of 5.2 per cent during this plan.

Seventh Five Year Plan (1985-90)

The amount allocated for the seventh five year plan was Rs. 29,770 crore. It was 22 per cent of the total plan outlay. Indian agriculture turned the corner in the fourth year (1988-89) of the seventh five year plan. The food grains production grew by 3.23 per cent when compared to the long-term growth rate of 2.68 during 1967-68. The average production of all crops in the seventh plan showed a substantial increase over the level of the sixth plan. The total food grains production increased to 171 million tonnes at the end of the seventh plan period. The growth rate was 3.13 per cent.

Eight Five Year Plan (1992-97)

During the eight plan, major efforts were made to restore and improve minor irrigation works. It aimed at not only achieving self-sufficiency in food, but also generating a surplus of specific commodities. The total food grains production during this plan was 176.7 million tonnes. The amount allocated during this plan for agriculture was Rs.52,000 crore. This amount was 14 per cent of the total plan outlay. The growth rate of agriculture was 3.9 per cent.
Ninth Five Year Plan (1997-2002)

During the ninth plan the allocated amount to agriculture was Rs.1,66,583 crore, which was 19.39 per cent of the total outlay of the plan. The food grains production was 189.4 million tonnes. The growth rate of agriculture was 4.1 per cent.

Tenth Five Year Plan (2002-07)

The tenth plan identified a number of key reforms including elimination of inter-state barriers to trade, and amendment to essential commodities etc. The agenda also proposed functions of trading in all commodities and removal of restrictions on financing, storing and trading. During this plan the allocated amount for agriculture was Rs. 3,05,055 crore, which was 20 per cent of the total outlay of the plan. The food grains production rose to 192.6 million tonnes.

Various Committees Appointed

Various committees have been appointed by the Reserve Bank of India and the Ministry of Finance, Government of India, to review the working of the RRBs from time to time.

Narasimham Committee

The Government of India appointed in July 1975, a working group on Rural Banks under the chairmanship of Shri M. Narasimham, the then Additional Secretarj in the Department of Economic Affairs, Government of
India to examine in depth the setting up of new Rural Banks as subsidiaries of the publics sector banks to cater to the credit needs of the rural people. The group submitted its report within a short period of one month on July 30 1975 recommending the establishment of Regional Rural Banks. The group identified the various weaknesses of the co-operative credit agencies and commercial banks. It felt that the existing credit institutions would not be able to fill the regional and functional gap in the rural credit institutional system within a reasonable period of time, even with adaptation, re-organisation and restructuring. Accordingly Regional Rural Banks were first set up by the Government of India in October 1975 largely based on the scheme recommended by the working group on Rural Banks.

Dantwala Committee

A committee was appointed in June 1977 by the Reserve Bank of India under the chairmanship of Professor M.H. Dantwala to review the working of the Regional Rural Banks (RRBs) in India. The main objectives of the Committee were:

1. To evaluate the performance of Regional Rural Banks in the light of the objectives for which they were set up,

2. To indicate their precise role in the rural credit-structure and

3. To make recommendations with regard to the scope, methods and procedures of their functioning and other matters germane to the enquiry.
The Committee elicited the Views of eminent persons in Gover
Reserve Bank of India, Commercial Banks and Institutions connected with
rural finance and banking on important problems. It also organized field
studies through the Economic Department of the R.B.I. by means of a
questionnaire to evaluate the working of some RRBs. The main findings of
the committee were as follows.

The RRBs had succeeded in recruiting local staff with rural orientation
and local touch to their business operation. They had succeeded in extending
their banking services to the unbanked rural areas. The performance of RRBs
with regard to the credit deposit ratio was distinctly superior compared to that
of the rural branches of Commercial banks.

Most of the RRBs could become financially viable in a period of about
3 to 4 years. But the RRBs could not succeed in covering a substantial portion
of the weaker sections of the population in providing loans. The overall
performance on different kinds of loans made by the RRBs was good. They
were much more efficient in the dispersal of loan to the rural borrowers
compared to the rural branches of commercial banks.

The Committee made the following suggestions for the effective
working of the RRBs.

1. The RRBs could become a very useful component in the totality of
rural credit structure with some modifications in their organization and
functions.

2. The expansion of RRBs be restricted selectively only to such areas
where both cooperative and commercial bank structures were weak.
3. The composition of share holding should be such that the Central Government held 25 per cent, the sponsor Bank 40, State Government 15 per cent and local participation 20 per cent.

4. The procedures used by the RRBs required further improvement. It was desirable to adopt the agriculture pass-book system to facilitate speedier loaning activity.

5. It was advisable to adopt graded scale of finance to different categories of borrowers. The RRBs should be permitted to lend upto 40 per cent of their loans to large farmers and other borrowers not covered by them at present.

Sivaraman Committee

The Committee to Review Arrangement For Institutional Credit for Agriculture and Rural Development (CRAFICARD) which was set up in 1981 under the Chairmanship of B. Sivaraman, felt that the RRBs had a large part to play in the effective coverage of credit needs of the weaker sections, so that the image of the RRBs as a small man's bank should be kept up. The Committee also favoured the continuance of various facilities provided by the Reserve Bank of India as well as the sponsoring banks to the RRBs as they were institutions devoting exclusive attention to the weaker sections and thereby deserving a special and differential treatment. It also recommended the establishment of a National Bank for Agricultural and Rural Development (NABARD) which also could look after the promotional and refinancing work besides inspection of the RRBs.
Kelkar Committee

The Government of India set up a working group on the RRBs in August 1984. Its main objective was to review the functioning of the RRBs and suggest appropriate measures to improve the performance of the RRBs. The working group emphasized the need for more effective involvement of the sponsor banks in the functioning of the RRBs. The following are some of the recommendations made by the committee:

I. Enhancement of the authorized and issued share capital of the RRBs,

II. The reduction in the rate of interest on refinance from sponsoring banks to the RRBs from 8.5 per cent to 7 per cent,

III. Removal of the present restriction by the NABARD which required the RRBs to bring down the credit deposit ratio to 100 per cent.

IV. Losses incurred by the RRBs for reasons beyond their control to be borne by Government of India, State Government and the sponsor banks in the same ratio as their shareholding,

V. More attention be paid to the consolidation of the existing RRBs. New RRBs might have to be opened in areas with predominantly SC/ST population taking into account the existing banking facilities and credit gap both in qualitative and quantitative term,

VI. The RRBs should not be allowed to finance bigger borrowers upto a given percentage of their (RRBs) total loans so as to improve their liability because bigger farmers would be in a position to get their credit requirements met through co-operatives or commercial banks,
The literature on Regional Rural Banks is vast and varied. Broadly it can be divided into three groups. The first group comprises of studies by various committees which focus their attention on the analysis of structure, share capital, jurisdiction, control and regulation, working and viability of Regional Rural Banks. The second group of studies comprises the performance appraisal studies of the RRBs at the macro level. The third group of studies deal with the impact of bank funding on the weaker sections at the micro level. A few of the prominent studies are reviewed in the present section in order to understand the areas of study covered and also the identify the research gaps for the present study.

Twenty Point Economic Programme (1975)

Mrs. Indira Gandhi as Prime Minister of India, during the 'Emergency' announced a "twenty-point programme" on 1st July 1975 for the upliftment of the weaker sections, which was to be the 'New Economic Programme of the Government of India'. Some of the "points" which had direct relevance to the credit system were: Liquidation of rural indebtedness; legislation for moratorium on recovery of debts from landless labourers; small farmers and rural artisans. These were aimed at relieving the people belonging to the weaker sections, from the clutches of moneylenders. This necessitated the government to seriously consider devising new alternative source of credit to meet their requirements as loans from private moneylenders would be dried up.
C. Regional Rural Banks

A working group was appointed by the Government of India in 1975 under the Chairmanship of Sri M. Narasimham to review the flow of institutional credit, especially to the weaker sections of the rural community. The working group recommended the setting up of state sponsored, regionally based and rural oriented banks called Regional Rural Banks to combine the local feel and familiarity of the rural problems which the cooperatives possess and the degree of business organization, ability to mobilize deposits, access to central money markets and a modernized outlook which the commercial banks have. Accordingly the government of India promulgated the Regional Rural Banks ordinance on September 26, 1975 setting up five RRBs on a pilot basis at Moradaband, Gorakpur (U.P) Bhiwani (Haryana), Jaipur (Rajasthan) and Malda (West Bengal). The RRB Ordinance was later replaced by the Regional Rural Banks Act 1976, which came into force with effect from 9-2-1976. Regional Rural Banks thus came to form an added component of the multi agency credit system for agriculture and rural development in India.

Regional Rural Banks are sponsored by commercial banks usually by public sector banks. RRBs are specialized farm credit institutions (SFCI) offering credit exclusively to the weaker sections of the society, such as small and marginal farmers, agricultural labourers, share-croppers, rural artisans, small entrepreneurs and self employed persons and other rural residents of small means at lending rates not higher than that charged by the co-operative societies.” By confining their lending to weaker sections of the society, it is being perceived as “Small man’s bank” meeting the regional and financial gaps in the working of the co-operatives as well as commercial banks.
REFORMS OF RRBs

Financial and Banking sector reforms (M.Narasimham-I and M. Narasimham-II) are desirable in promoting the socio-economic justice from time to time based on the reports of banking submitted by different committees in different years. The list of reforms in relation to Regional Rural Banks is as: Capital adequacy norms laid down first time in 1992-93, prudential norms regarding non-performing assets laid down in 1993-94, cash reserve ratio cut from 13 per cent to 10 per cent in 1995-96, and Kisan Credit Card introduced. The concept of 'Financial Inclusion' introduced in the year 2005-06 and Micro, Small & Medium Enterprises Development Act, 2006 enacted in the year 2006-07.

Although a series of banking reforms have been initiated since 1993 to make the Regional Rural Banks system viable. Recent assessments suggest that the performance of the Regional Rural Banks in the post-reform period has been less encouraging than increasing expected. While aggregate profitability seems to have improved slightly, becoming less negative the overall quality of loan portfolio management, administration and collection still remains a matter of grave concern. Accumulated Regional Rural Banks losses upto March 31, 1998, were reported at almost Rs.27,870 million; losses for the year ending that date were Rs.736.5 million by a gradual increase in the average loan size and the continued bias against women borrowers. As a result, the dependence of the rural poor on informal credit continues to be significant. This has seminally defeated a central objective of the government's rural development strategy which is to deepen and widen the availability of finance to India's historically excluded communities.
The efforts to reform the Regional Rural Banks have had a limited impact because reformers have paid little attention to the institutional dimensions of the problems facing the banks. Specifically, few efforts were made to redesign the perverse institutional arrangements that gave rise to incompatible incentive structures for key shareholders such as politicians, policy makers, stockholders, bank staff and clients. The next leg of reforms focus is on aligning the incentives of these shareholders by giving greater importance to the internal organizational context as well as the larger policy environment within which the Regional Rural Banks operate.

Key RRBs Reforms: Based on the recommendations of the Narasimham Committee Report (1992), reforms were initiated in 1993 to turn the failing Regional Rural Banks around. To enhance financial viability, a new set of prudential accounting norms of income recognition, asset classification, provisioning and capital adequacy were implemented. Banks were also required to make full provisioning for bulk of their non-performing assets. Also they were permitted to lend to non-target group borrowers upto 60 per cent of new loans beginning in 1993-94. A number of studies indicate that while the reforms have introduced an enabling environment for efficient financial transactions, they have done little to increase the internal efficiency of the Regional Rural Banks. Attaining financial viability is the new constraint to maximize the performance with the least risks and costs. It is not surprising note that Regional Rural Bank managers seem to have reduced their lending to disadvantaged groups and increased their money market investments.
First, managers understand that without reduced transaction costs, incentives for repayment and innovative loan products in place, it is difficult to expect previous borrowers who are not accustomed to the culture of loan repayment, to change their behavior and repay new loans on time. Therefore, lending to old clients is risky.

Second, although it is possible for them to make loans to the non-target group clients from outside of their service areas, most Regional Rural Bank managers find themselves lacking in credit-appraisal skills. Again, lending without analyzing the quality of the credit is risky.

Third, making new loans requires filling out redundant forms, screening and monitoring borrowers diligently and pursuing collections intensively, if one is to be in compliance and maintain good asset quality. Although Regional Rural Bank reforms have led to blanket salary increases, they have done little to introduce incentives for better performance. Thus, making good loans might be personally costly to the managers. Under these circumstances, it is hardly surprising that the current institutional constraint of financial Viability has led many managers to conclude that "the secret [to branch profitability] is not to lend; or if [one has] to lend, to lend as little as possible"

Unfortunately, the Regional Rural Banks reform process has not given enough attention to designing institutional arrangements that can align the incentives of policy makers with those of banks' field staff and clients.
Neglecting this aspect of reform can be detrimental to program viability. The internal efficiency of the Regional Rural Banks will not likely improve unless the field staff actively participates in the reform process. To say that, vesting the Regional Rural Banks branch managers with the authority to make lending decisions and freeing the staff from redundant and time consuming reporting requirements can not only boost morale but can also serve as the foundation for making good loans and operating efficiently. In addition, not only should Regional Rural Bank branches have group incentives for meeting and exceeding the outreach and sustainability targets for their profit centers, there also need to be upfront improvements in the operational infrastructure of the banks. Such actions which can include management information systems to facilitate data storage, retrieval and manipulation in addition to other facilities can serve as signals of credible commitment on part of the owners and may go a long way in turning the Regional Rural Banks around.

While rural clients will certainly notice the introduction of new banking values, investments in physical improvements may not be sufficient to change their perceptions regarding the innate inefficiencies of the Regional Rural Banks. It may be critical to provide them with information at village level forums regarding the new and improved business practices of the banks. Incentives such as intensive collection strategies and interest rebates for prompt payment will encourage timely loan repayment. In sum, the key to turning the Regional Rural Banks around and placing them on a path of increasing outreach and sustainability is to devise and implement institutional arrangements that harmonize public interest objectives with the private incentives of bank staff and clients.
The political leaders can become allies, reforms can transform failing programs into models of success, as has been the case for Indonesia's BRI Unit Desas - money-losing branches of a State-owned bank that became profitable within two years of reforms. Until such time as leaders feel confident that furthering the public interest is possible without political suicide, proposals that seem to adversely impact either the agricultural sector, or socially/economically weak communities, are unlikely to find support. Thus, educating political leaders and winning over their support will be critical for implement the needed reforms and ultimately making the Regional Rural Banks viable.

Progress of RRBs

The details relating to the progress of RRBs since inception are shown in Table 1.7.

<table>
<thead>
<tr>
<th>Year</th>
<th>No. of RRBs</th>
<th>No. of District covered</th>
<th>No. of branches</th>
<th>Deposits (Rs.crore)</th>
<th>Outstanding credit (Rs.Crore)</th>
<th>Credit Deposit Ratio (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1975</td>
<td>6</td>
<td>12</td>
<td>17</td>
<td>0.2</td>
<td>0.1</td>
<td>50</td>
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<td>1980</td>
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<td>144</td>
<td>3279</td>
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<td>188</td>
<td>333</td>
<td>12606</td>
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<tr>
<td>1990</td>
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<td>380</td>
<td>14511</td>
<td>4267.52</td>
<td>3560.17</td>
<td>83</td>
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<tr>
<td>1995</td>
<td>196</td>
<td>425</td>
<td>14509</td>
<td>11150</td>
<td>6291</td>
<td>56</td>
</tr>
<tr>
<td>2000</td>
<td>196</td>
<td>484</td>
<td>14301</td>
<td>32204</td>
<td>13182</td>
<td>41</td>
</tr>
<tr>
<td>2005</td>
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<td>523</td>
<td>14484</td>
<td>68912</td>
<td>32870</td>
<td>53</td>
</tr>
<tr>
<td>2010</td>
<td>82</td>
<td>586</td>
<td>15.444</td>
<td>142980</td>
<td>82221</td>
<td>58</td>
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</table>

Source: 1. RBI, Report on currency and finance, various issues,
2. Basic statistics, India, various issues.
In the last two decades the expansion and area of operation of Regional Rural Banks have been impressive. The number of RRBs rose to 196 but declined to 82 in 2010. The number of branches increased from 17 to 15,444 and that of districts covered went up from 12 in 1975 to 586 in 2010. Deposits with RRBs which amounted to only 0.20 crore in 1975 rose to Rs.142980 crore in 2010 and the outstanding were only Rs.10 lakhs had an impressive rise to Rs.82221 crore in the same period. These small men's banks have played an important role in mobilizing rural savings as they are the nearest banking institutions to rural households. Since the main purpose of setting up these banks was to meet the credit needs of the rural poor, they paid specific attention to this aspect. It is important to note that the weaker sections received more than 90 per cent of the total direct advances of RRBs. Moreover, 90 per cent of their branches have been opened in unbanked rural centres.

BUSINESS OF REGIONAL RURAL BANKS

Data on the business operations of Regional Rural Banks are given in Table 1.8.

Branches: Table 1.8 discloses that initially, the Regional Rural Banks were six in number which increased to 188 banks in December 1985 covering 333 districts with branch network of 12606 and to 196 banks covering 363 districts with 13353 branches by December 1987. The number of Regional Rural Banks remains the same, but their branches increased to 14484 covering 523 districts in the country by March 2005. It can be deducted that the growth of Regional Rural Banks is phenomenal upto March 2005. Once the consolidation and amalgamation process took place in September 2005, the number of Regional Rural Banks have decreased drastically from 196 to 133 in the year 2006. Further, it is decreased to 82 in March 2010.
<table>
<thead>
<tr>
<th>Year</th>
<th>No. of RRBs</th>
<th>No. of Branches</th>
<th>Districts</th>
<th>Deposits (Rs.)</th>
<th>Advances (Outstanding) (Rs.)</th>
<th>CD Ratio</th>
<th>Per RRB</th>
<th>Per Branch</th>
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<td>Deposits</td>
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<td>Other</td>
<td>Number of Branches</td>
<td>Total Branches</td>
<td>Total Loans</td>
<td>Interest Rate</td>
<td>Number of Loans</td>
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<td>82221</td>
<td>57.51</td>
<td>1743.88</td>
<td>1002.70</td>
</tr>
</tbody>
</table>

Source: NABARD, Statistics on RRBs, Various Issues

* Excluding Satellite branches
The branches of Regional Rural Banks have come down to 14484 in 2005 from 14527 in 1991. Towards this declining trend, the attributable fact is that it is due to implementation of the norms of liberalization policy in 1991 restricting the branches, so as to have sound business operations leading to better margin and better profit. This feature is welcoming the scenario of rural credit. Further, it is also noticed that the increase of geographical coverage is accompanied with decrease in branch network. This fact, without doubt spelt out that the Regional Rural Banks are aimed at the well being of rural people and rural sector. Of course, the existence of Regional Rural Banks themselves is oriented towards the rural India and its progress economically.

The above analysis clearly indicates that more coverage with expanding branch network without increase in number of Regional Rural Banks with restructuring the existing branches into viable operations which are an obvious thought. The Dantwala Committee in its conclusion said that "the performance of Regional Rural Banks in the spread of banking was quite satisfactory". The financial soundness of Regional Rural Banks is visualized through mobilization of deposits and deployment of credit.

Deposits: Table 1.8 also discloses that deposit mobilized by six Regional Rural Banks was 0.28 crore in 1975 which increased to Rs.8827 crore in 1985, to Rs.62413 crore in 2004-05 and to Rs.142980 crore in 2010. This clearly indicates the Regional Rural Banks have a tremendous development which is a welcome sign to the banking functioning of Regional Rural Banks.
The Regional Rural Banks have an outstanding of advances Rs.0.10 crore in 1975. During 1985 to 1995 the advances of Regional Rural Banks were increased to RS.6291 crore from Rs.1408 crore or increased by Rs.488.3 crore annually. The advances of Regional Rural Banks increased to RS.26114 crore or increased by Rs.2068 crore annually during pre-amalgamation period. The advances of Regional Rural Banks have become doubled during the post-amalgamation period from Rs.26114 crore to 82221 crore in 2010. The annual average increase in advances during the period is Rs. 8409 crore. It is inferred that the outstanding advances of Regional Rural Banks are increased substantially; thus satisfactory in quantitative terms.

Per Bank: Table 1.8 shows that the deposits mobilization of per Regional Rural Bank is accounted for Rs.0.03 crore, while its advances are Rs.0.02 crore in 1975. The corresponding figures are Rs. 6.34 crore and 7.49 crore; Rs.21.08 crore and Rs.18.13 crore; Rs.56.89 crore and Rs.32.10 crore; Rs.164.31 crore and Rs.67.27 crore; Rs.287.50 crore and Rs.133.23 crore and Rs.1743.66 crore and Rs.1002.70 crore in 1985, 1990, 1995, 2000, 2004 and 2010 respectively.

The recorded progress in mobilization of deposits and deployment of credit per Regional Rural Bank in 1990, 1995, 2000, 2004 and 2010 is accounted for Rs.14.24 crore and RS.10.92 crore; Rs.35.81 crore and Rs.13.97 crore; Rs.107.42 crore and RS.35.17 crore; RS.123.19 crore and RS.65.96 crore and Rs.702.89 crore and Rs.523.37 crore respectively. The increased progress of per Regional Rural Bank in mobilization of deposits is
accounted by 3.10 fold in 1990 over 1985; 2.70 fold in 1995 over 1990; 2.89 fold in 2000 over 1995; 1.93 fold in 2005 over 2000 and 1.85 fold in 2008 over 2005. The corresponding figures for advances are accounted for 2.42 fold; 1.77 fold; 2.10 fold; 2.49 fold and 2.20 fold increase respectively.

Per Branch: The per branch deposits mobilization and deployment of credit are accounted for Rs.0.01 crore and Rs.0.01 crore in 1975; Rs.0.10 crore and Rs.0.11 crore in 1985; RS.0.29 crore and RS.0.25 crore in 1990; Rs.0.77 crore and Rs.0.43 crore in 1995; Rs.2.55 crore and Rs.0.92 crore in 2000; Rs.4.29 crore and Rs.2.27 crore in 2005 and Rs.6.08 crore and Rs.4.03 crore in 2008 and and 9.26 crore and 5.32 crore in 2010. Though the progress registering in deposit mobilization till today. In other words, during pre-amalgamation it is on an average, 18.13 per cent and after amalgamation it is 13.90 per cent. It reveals that there is little decrease in the progress of deposits mobilization of per branch during post-amalgamation. Similarly, the progress of credit deployment is also increasing but during pre-amalgamation it is on an average, 29.34 per cent and after amalgamation it is 25.84 per cent.

It is known that there is little decrease in the progress of credit deployment of per branch. It is learnt that per branch efficiency in terms of deposit mobilization as well as credit deployment is less when compare to pre-amalgamation period. From the above analysis, it is understood:

a) Per Regional Rural Bank performance as well per branch of Regional Rural Banks in terms of annual progress in deposits mobilization and credit deployment is accounted for declined progress after the amalgamation process takes place.
b) On comparison with reference to deposits mobilization and credit deployment, the performance is far better in former both in per Regional Rural Bank and per branch of Regional Rural Bank. Undoubtedly this fact discloses that the Regional Rural Banks are moving towards self-reliance. The observations on the progress of Regional Rural Banks in comparison with commercial banks are thus:

d) The branches of regional rural banks are constituted about one sixth of branches of commercial banks in 1975 which went up to about one-fourth in 2005. In relation to the rural branches of all commercial banks, the branches of Regional Rural Banks are accounted for 43.22 per cent in 1985 which rose from one-third in 1975 and went up to 37.40 per cent in 2005.

e) The branches of Regional Rural Banks are accounted for 19.58 per cent of the total branches in 2008 and their deposits of Rs.90126 crore which accounts only 2.7 per cent of total deposits in India and advances of Rs.59751 crore constitute a still of lower share of 2.02 per cent. Similarly, the rural branches of Regional Rural Banks are accounted for 36.94 per cent of the total rural branches of all the banks put together. But, their share in institutional agricultural advance is not more than 11 per cent.

In terms of deposits mobilization, the performance of Regional Rural Banks and its branches is praiseworthy. Per branch performance is still better during 2005-10 post-amalgamation periods.
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