CHAPTER I
"Banking, in the rural sector for the benefit of the rural households has to be in tune, to the maximum extent, with the social and economic environment in which the rural people live". Rural India is real India. The economic fortunes of India depend upon the prosperity of Rural India. A majority of the Indian rural population is dependent on the agricultural and allied sectors for its livelihood. All productive activities in rural India, agriculture or industrial intended for market or self consumption need sufficient investments and expansive credit back up. Consistent and considerable efforts have therefore, been made ever since 1904 to meet efficiently the ever increasing demand for credit in farming and non-farming sectors through the establishment of different types of credit institutions in rural India. As a result, a mammoth institutional structure has been raised over the years for financing rural development in general and agricultural development in particular. Starting with the Co-operative credit structure, followed by rural branches of the nationalised banks and then the Regional Rural Banks (RRBs), the institutional structure has grown and expanded. But, the desired results have not been forthcoming. The emphasis on credit expansion prescribed by the policy makers and practiced by the formal financial Institutions (FFIs) in India, over the past decades have ended up in quantitative suel impressive growth rate both in terms of number of outlets and credit deployment. However, it is noted with concern that quantitative expansion has not resulted in quality of lending services on the part of financial institutions (FFIs) and repayment response on the part of the borrowers. The improvement in credit delivery, usage of credit, credit

1 Reserve Bank of India, Report of the Committee to Review Arrangements for Institutional Credit for Agriculture and Rural Development (CRAFICARD), Bombay, January 1981, p.29.
productivity, followed by "will to recover" and positive client repayment response are yet to be fully achieved. Alarming proportions of overdues in the financial Institutions (FIs), blocking the credit flow and consequent recycling, high cost and non-viability have been the stress area for the institutions dealing with financial intermediation. However, instances where the percentage of credit usage, technology absorption, surplus generation, savings and final repayment by the borrowers in selected experimental areas in Tamil Nadu\(^2\) and elsewhere in India are not wanting.

The present chapter is divided into two sections viz., review of the evolution of the Rural Credit System and presentation of its problems.

**Evolution of the Rural Credit System in India**

Rural Financial Market Development is a complex process. Institutional Credit System for the rural sector for financing agriculture and other rural activities commenced in India in the early part of this century with the organisation of Co-operative Credit Societies. The Co-operative Credit System was refurbished in the mid-fifties in the wake of the recommendations of the All India Rural Credit Survey Committee (AIRCS-1954). The recommendation of the committee forms the edifice for the policy towards the development of the institutional credit structure. The committee highlighted the awful inadequacy in the supply of institutional credit to the rural sector and proposed an integrated scheme through reorganisation of the system of rural credit. The committee also recommended the conversion of the Imperial Bank of India into State Bank of India to extend banking facilities in the countryside; following it, the Government of India, the Reserve Bank of India and the State Government made special efforts to foster the growth of the

Co-operative Movement. As a result, the share of Co-operatives in rural credit increased from three per cent in 1951 to 11 per cent in 1961. However, the movement, is yet to make its due contribution in many states since Co-operative Credit could not be developed uniformly in all parts of the country. The Co-operatives were the main sources of formal credit for agriculture till the green revolution demanded substantial credit requirements from agricultural sector.

The spurt in the demand for credit due to diffusion of the green revolution exposed the inability of Credit Co-operatives to meet the challenges and led to the social control on Commercial Banks and the nationalisation of 14 major banks in 1969 (followed by the nationalisation of 6 more banks in 1980) with emphasis on lending to priority sector-agriculture, rural artisans, small scale industries, small business, retail trade, road and water transport operations etc., thus, Commercial Banks were inducted in to the field of agricultural credit and rural banking got a boost. This simultaneous operation of different type of banks (Co-operative and Commercial) in rural areas can be known as the "Multiagency Approach to Rural Credit".

**Rural Credit Scenario**

Our exposure to rural credit system over the years points out two types of scenarios. While the first is a positive one which is a matter of gratification, the second is negative type which is causing concern to those who are engaged with the management of rural credit system. The positive impact of the dynamic as well as innovative changes in the system has been evident from the data on the relative position of various agencies involved in the peasant borrowers at four crucial stages - 1951, 1961, 1971 and 1981. The share of formal institutional agencies in the total credit disbursement has
increased from a mere 7.30 per cent in 1951 to 18.70 per cent in 1961, 31.50 per cent in 1971 and in 1981, 62.50 per cent. From the available statistics, it is obvious that the rural credit institutions have succeeded to a considerable extent in achieving their principal aim of replacing the widely prevalent usurious money lending.

The progress achieved by the Multiagency Rural Credit System has also been quite impressive in quantitative terms. Over a period of time, a large number of credit institutions started functioning in the rural areas. There are about 33,000 rural and semi-urban branches of Commercial Banks, over 90,000 primary agricultural credit societies, over 2,000 branches of land development banks and nearly 15,000 branches of Regional Rural Banks operating in the country side, thereby making easy access to credit to large population. The Average Population Per Bank Office (APPBO) is limited at 15,000 (1996).

Geographically speaking, the block head quarters have become banked centres, each one of the villages at the grass root level in India is covered under banking fold. Similarly, several policy measures, stipulation under priority sector lending, specific schemes for poverty alleviation were made effective, which no doubt, expanded and improved the credit delivery system in the rural areas under service area approach. Ultimately, credit has been deliberately taken to the door steps of the rural people. The credit facilities made available by the banks to the priority sectors have increased

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3 Reserve Bank of India, Quarterly Handout, Advanced Statistics on Co-operatives, Bombay, June 1996.


5 Reserve Bank of India, Quarterly Handout, Data on Co-operative Banks, Bombay, March 1996.
from 13 per cent of net bank credit (1969) to 42 per cent (1994). The total bank credit to the priority sectors as on March 1994 crossed the level of Rs. 50,000 crores benefiting 3.58 lakhs borrowers. The direct agricultural advances of banks have reached the level of Rs. 17,835 crores, spread over 273 lakhs borrowal accounts, comprising nearly 18 per cent of the net bank credit\(^6\).

Problems of Rural Credit System

The other side of the scenario shows a myriad of negative features of rural banking. While the achievements in the rural banking sphere have been quite impressive, the unprecedented expansion of banking facilities has brought in its wake several problems. The three main constituents of rural banking in the country viz., Co-operatives, Regional Rural Banks (RRBs) and Commercial Banks have been experiencing problems which include: presence of loss incurring Commercial Bank branches, unprofitable RRBs, dormant and unviable Co-operatives, non-performing assets (both from the point of supplier and user of rural credit), accumulation of overdues (a necessary evil in the management of rural banking), lack of supporting facilities to the credit scheme\(^7\) (nou credit inputs). These problems are mainly centering round the issues of viability of rural credit (both from the view point of banker and borrower) in the context of the regime of ululated and concessional interest rates and directed lending programmes. The other major institutional weaknesses are: weak recycling of credit, poor deposit mobilisation and ineffective lending and misutilisation, leakages, malpractices and wilful default.

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\(^6\) Chada, B.L. "Toning up the Rural Credit System to improve viability". *Financial Express*, April 23, 1995

\(^7\) This fact has been printed out in various reports of the committees like *CRAFICARD*, 1981, *ACRC*, 1989, Working group on the working of Lead Bank Scheme and *RBI* studies on rural lendings, 1969.
on the part of the borrowers particularly after the advent of subsidy (a villain of the piece or panacea for bringing social equity)\(^8\).

**Poor Recovery**

The main area of grave concern relating to rural credit has been the low rate of recovery. The large scale expansion of rural credit during the past three decades has not been accompanied by good rate of recovery. The data on recovery performance of the credit institutions at the aggregate level during the last one decade (1982-1983 to 1991-1992) amply exposes this point.

Table 1.1 Recovery Performance of Credit Agencies in India

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Year</th>
<th>Primary Agricultural Credit Societies (PACs)</th>
<th>Primary Land Development Banks (PLDBs)</th>
<th>Regional Rural Banks (RRBs)</th>
<th>Commercial Banks (CBs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>1982-1983</td>
<td>60</td>
<td>52</td>
<td>52</td>
<td>55</td>
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<tr>
<td>2</td>
<td>1983-1984</td>
<td>59</td>
<td>52</td>
<td>50</td>
<td>52</td>
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<tr>
<td>3</td>
<td>1984-1985</td>
<td>59</td>
<td>55</td>
<td>48</td>
<td>54</td>
</tr>
<tr>
<td>4</td>
<td>1985-1986</td>
<td>59</td>
<td>61</td>
<td>49</td>
<td>56</td>
</tr>
<tr>
<td>5</td>
<td>1986-1987</td>
<td>60</td>
<td>59</td>
<td>50</td>
<td>57</td>
</tr>
<tr>
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<td>1987-1988</td>
<td>62</td>
<td>54</td>
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<td>57</td>
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<tr>
<td>7</td>
<td>1988-1989</td>
<td>62</td>
<td>52</td>
<td>49</td>
<td>57</td>
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<tr>
<td>8</td>
<td>1989-1990</td>
<td>51</td>
<td>28</td>
<td>34</td>
<td>49</td>
</tr>
<tr>
<td>9</td>
<td>1990-1991</td>
<td>57</td>
<td>56</td>
<td>47</td>
<td>58</td>
</tr>
<tr>
<td>10</td>
<td>1991-1992</td>
<td>NA</td>
<td>49</td>
<td>40</td>
<td>57</td>
</tr>
</tbody>
</table>


Analysis of the data on the bank-wise recovery as percentage to demand from Table 1.1 revealed a distinct pattern for the first seven years, i.e., up to 1988-1989. The percentage of recovery to demand ranged generally within a narrow band of three to five percentage points except in the case of Land Development Banks, in respect of PACs, the percentage of recovery ranged between 59 and 62, while in the case of RRBs, it was 48 to 52 and in respect of Commercial Banks, the same was between 52 and 57. However, in the case of Land Development Banks, although the recovery position during 1982-1983 and 1988-1989 remained unchanged at 52 per cent, there was an improvement in the recovery during 1984-1985 to 1987-1988. During the period 1989-1990 to 1991-1992, the recovery performance of all types of credit institutions was affected adversely. This was mainly due to the waiver of agricultural loans in 1990 which had severely aggregated the problem of recovery. The recovery position of PACs had declined in 1989-1990 to 51 per cent from 62 per cent in 1988-1989 (reduction in recovery rate by 11 per cent). The recovery position of Land Development Banks had plummeted in 1989-1990 to 28 per cent from 52 per cent in 1988-1989 (reduction in recovery rate by 24 per cent).

The recovery position of RRBs had reached a low level of 34 per cent during 1989-1990 from 49 per cent in the previous year (reduction in recovery rate 15 per cent) and the Commercial Banks had also shown a low recovery performance at 49 per cent during 1989-1990 as against 57 per cent during 1988-1989 (reduction in recovery rate by eight per cent). However, inspite of the "poor recovery" performance record in the year 1989-1990, all the institutions showed slightly improved recovery position during 1990-1991. The increase in recovery rate is by six per cent, 28 per cent, 13 per cent and nine per cent in respect of PACs, LDBs, RRBs and CBs respectively. But, it is also to be noted that this improved recovery position was mainly attributed to
the adjustments of relief granted under Agricultural and Rural Debt Relief Scheme\(^9\). Even during the year 1991-1992, there has been deterioration in the recovery performance of these institutions and the recovery position of Land Development Banks has declined from 56 per cent in 1990-1991 to 49 per cent in 1991-1992 whereas, the reduction in recovery position of RRBs is by seven per cent and one per cent in the case of Commercial Banks. An analysis on the trend of recovery between the period 1987-1988 and 1991-1992 revealed that there was a fall in recovery in respect of all the four credit institutions except the Commercial Banks in which case the recovery position had reached the Pre-ARDRS level of recovery during 1991-1992.

The recovery performance of RRBs in this respect was abysmally poor. The clientele of RRBs being primarily from the weaker sections of society are more prone to default in repayment in the absence of alternative source of Income\(^10\).


The data on recovery performance of different banks in different years (within the decade) revealed that while PACs performed better acquiring first place in seven years and second position in two years. The Commercial Banks were observed to be next to PACs. These banks secured first position in two years (that too after loan waiver period i.e., 1990-1992) second position in five years and third in three years. The recovery performance of RRBs was the least among the four credit agencies exhibiting bottom position in six years and third in four years. The performance of PLDBs was also no better than


that of RRBs. The PLDBs stood first in one year, second in four years, third in four years and fourth in one year. Though the PACs had a better recovery performance record during the past ten years, they had achieved a recovery of 60 per cent and above 60 per cent of demand in four years i.e., 1983, 1987, 1988 and 1989. But in the subsequent years their recovery performance had declined. The Land Development Banks also had registered recoveries of more than 61 per cent of demand in the year 1986.

Whereas, the Regional Rural Banks and Commercial Banks failed to achieve 60 per cent of recovery of loans as percentage to their demand during the period under review. The loan recovery is the lowest in the Regional Rural Banks hovering around a maximum of 52 per cent of demand and that too at the beginning of the review period (1982-1983) and the general trend has been towards deterioration over the years.

From the analysis of the data on recovery performance of four institutional agencies, the following disturbing inference would be derived:

(i) The valuable resources deployed in the rural sector got blocked in the hands of their borrowers as overdues,

(ii) Poor rate of recovery in all the institutional agencies has a serious demoralising effect on the bank's lending machinery,

(iii) The number of difficult borrowers and hard-core overdues is increasing over the years which call for vigorous efforts on the part of bankers and support from the Government failing which flow of credit to the rural sector may get reduced or restricted,

(iv) The only silver lining in this "Scenario" was the period from 1985 to 1989 when the loan recovery position registered a slight
improvement. This may be attributed partly to the intensified efforts made by the banks and also due to the Government, Reserve Bank of India, and NABARD's Schemes for helping the agriculturists during natural calamities by introducing rehabilitation measures of conversion of crop loans to term loans by rephasing and rescheduling of repayment programmes. But this phenomena were short lived and in the year 1990 there was a steep decline in recovery of dues in all the four institutions. The announcement as well as the implementation of Agricultural and Rural Debt Relief Scheme 1990 brought a paradoxical situation in the loan recovery atmosphere. An amount of Rs. 7917 crores provided to the public sector banks, under the Agricultural and Rural Debt Relief Scheme, brought only a temporary relief to the bankers without any permanent solution to the problem.

The NABARD has identified and listed out a wide range of factors which influenced the level and the trends in recovery performance of the agricultural credit institutions. An analysis of factors influencing the level and trend in recovery performance external to the credit agency comprise:

(a) natural calamities like floods and draughts, (b) defective legal frame work and lack of Government assistance in effecting recoveries through legal measures, (c) Socio-political environment in which the credit agencies are required to function etc., In agricultural projects and production programmes, (a) the absence of linkages for ensuring input and supplies, (b) extension services on the one hand and processing, storage, marketing and other services on the other are serious lacunae, impairing effective use of the assets and impeding the production activities resulting in realisation of low level of income. Factors internal to the credit system, directly affecting recoveries include, defective loan policies and procedures, inadequate supervision over
credit and unsatisfactory end use of credit, delay in sanction and disbursement of loans, fixation of shorter repayment periods, absence of initial grace period, failure to provide working capital to borrowers of term credit and over emphasis on target approach. The delinquency in repayment of loans has been inhibiting credit expansion and economic viability of the lending institutions, especially, of the RRBs and the Co-operatives. Numerous committees have gone into the problems of overdues and made recommendations over the years. Several measures have also been initiated by Reserve Bank of India and National Bank for Agriculture and Rural Development to improve the viability of Co-operatives and RRBs. But most of them suffer from the weakness of a top-down framework; and instances where they differed and might have made a positive impact, have remained implemented. As a result, attempts to rectify the problems of the Rural Credit System have tended to be half baked solutions with a short-term perspective in mind. As against this background the present study has been carved out with a main focus on recovery and overdues management of financial institutions i.e., RRBs both at macro and micro level.