# Chapter IV

## Role of Commercial Banks in Rural Credit

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Institutional finance is the lifeblood of modern economic system without which no system can survive. In agricultural development also its role is crucial. Adequate institutional credit is considered to be the most important factor, which if suitably provided, will go a long way to put the economy of the farmers especially the small and marginal farmers on a sound footing (Selvaraj 1998). So agriculture and rural development has been on the priority agenda of our policy makers since independence and considerable efforts have been made to develop the rural credit system as means of rural development (Joshi 1997, Tyagi and Singh 1998).

This chapter is divided into two sections:

Section 1: Rural Development

Section 2: Role of Commercial Banks in Rural Development

Section 1
Rural Development

4.1.1 Introduction
The term rural development refers to a wide array of developmental programmes aimed at developing rural areas through the creation of infrastructure facilities to ameliorate the condition of rural people. The very concept of rural development on the global level had its origin in the mid 17th century in England. A group of people called ‘Quakers’ or friends organized themselves on the principles of selfless sacrifice. They believed in the dignity of all human beings. This philosophy was propagated throughout the world.
In India rural development is recognized as a sine qua non for faster economic development and welfare of common masses. Rural development is not merely development of rural areas but also the development of the rural people into self-reliant and self-sustaining modern little communities. Rural development is, therefore, the development of rural areas in such a way that each component of rural life changes in a desired direction and in sympathy with the other component. Besides, rural development also encompassed structured changes in the socio-economic situation in the rural areas in order that human welfare, which is the primary goal of all development, is secured at the earliest. Rural development, thus, should embrace all the objectives of enrichment and betterment of the overall quality of the rural life through appropriate development of manpower resources, infrastructural facilities and provision of minimum needs and livelihood.

It has been the constant endeavor of the planners to give adequate thrust to rural development as the sector is directly related to agriculture. The focus has never shifted from developing the country’s vast tracts of rural lands, where the majority of population exists. In the first five year plan (1951-55) top priority was given for agriculture, including projects that combined irrigation and power generation. By contrast, the second five-year plan (1956-60) gave importance to industry (Theodore 2005). The third five year plan (1961-65) aimed at a substantial rise in national income, while expanding the industrial base and rectifying the neglect of agriculture in the previous plan. It aimed at self-sufficiency in food grains (Theodore 2005). The 4th five year plan (1969-73) gave adequate priority to agriculture, including irrigation, which received 23 percent of public outlays (Theodore 2005). The 5th five year (1974-78) was in effect for only one year providing guidance to investments (Theodore 2005). The 6th plan (1980-84) allocated 24 percent of public development funding to irrigation. The major objective of the plan was poverty eradication and increase in employment opportunities, especially in rural areas (Government of India 2005). The 7th pan (1985-89) gave importance to energy and social sector neglecting agriculture (Government of India 2005). The 8th plan (1992-96) was affected by policy changes of government and among many things priority was accorded to agriculture and rural development (Government of India 2005). However, the

There has been a paradigm shift in the policy of rural development. The rural poor are now being treated as a resource, whose ideas and experiences form an integral part of development strategy. (Theodore 2005). To ensure sustainable development of rural areas, the allocation for rural development was increased substantially. As against a budgetary allocation of Rs.12,265 crores during 2001-02 the amount was increased to Rs.14070 crores in 2003-04 and to Rs.15998 crores in 2004-05 (Government of India 2005).

4.1.2 Schemes for Rural Development

The Government of India has designed and implemented a large number of schemes for creation of employment, eradication of poverty and for ensuring overall development in rural areas. Commercial Banks are the main players in the implementation of these schemes.

Integrated Rural Development Programme (IRDP)

IRDP was implemented in 1980 for increasing production and productivity in agriculture and other sectors in rural areas, creation of substantial employment opportunities and making the rural families viable and self-sufficient. The programme seeks in particular to improve the lot of poorest of the poor – small and marginal farmers, sharecroppers, agricultural labourers, rural artisans, scheduled caste/tribes and other weaker section. The government provided subsidy ranging from 25 percent to 50 percent of the total capital investment depending upon the category of beneficiaries (Srivasthava 2000).

Service Area Approach (SAA)

The RBI started SAA for rural lending in 1988. It refers to a system of assigning special areas to each bank branch in which it can concentrate for productive lending and thus contribute to the development of the area. The SAA is intended to bring about a major
change in the quality and productivity of rural lending. It aims at making available adequate and timely credit for meaningful activities and ensuring effective recycling of bank funds (Maheswari and Paul 2001).

**Lead Bank Scheme (LBS)**
The LBS was introduced by the RBI in 1969 with the objective of enabling the commercial banks to assume the role of leadership for the development of banking and credit facilities throughout the country on the basis of area approach. Under this scheme, all the districts in the country have been allotted to different banks. A lead bank is assigned the role of a catalytic agent of economic development through the expansion of bank branches and diversification of credit facilities in the district allotted to it. It is made responsible for surveying the resources and potential for banking development in the district (Maheswari and Paul 2001).

**Differential Interest Rate (DIR)**
The DIR scheme was introduced in 1972 with a view to provide bank credit to the weaker sections of the society at a concessional rate by PSBs. The banks identify beneficiaries who will be eligible for loans under the scheme and conditions under which loans should be given. Different interest rates are charged by CBs on advances to different categories of borrowers on the basis of income and repayment capacity (Maheswari and Paul 2001).

**Small Farmers Development Agency (SFDA)**
The SFDAs have been established to help those cultivators who have small, yet potentially economically viable holdings. The small farmers have always been neglected by both the organized and unorganized sectors of banking. Therefore, the establishment SFDA is a significant development in the field of rural finance, for it forms an important link in the chain of organized financial institutions through which money flows into the rural sector of the economy (Srivasthava 2000).
Marginal Farmers and Agricultural Labourers Development Agencies (MFAL)
The MFALs have been established to help sub-marginal farmers and agricultural labourers. Marginal farmers with holdings up to one hectare and agricultural labourers who earn more than 50 percent of their income from agriculture receive subsidised credit support for agriculture and subsidiary occupations under this scheme. The subsidised credit support is given for dairy farming, poultry, fishery, piggery, sheep rearing, horticulture etc. (Srivasthava 2000).

Farmers Service Societies (FSS)
On the basis of the recommendations of the National Commission on Agriculture, Farmers societies have been organized by CBs in SFDA and MFAL areas from 1973-74. The basic objectives of the scheme of FSS have been to offer to small farmers a full package of services and technical guidance instead of just credit (Srivasthava 2000).

Swarnajayanthi Gram Swarozgar Yojana (SGSY)
The SGSY has been launched as an integrated programme for self employment of the rural poor on 1st April 1999 by merging hither to self employment programme of DWCRA, TRYSEM, SITRA, GKY and MWS. The objective of the scheme is to bring the assisted poor families above the poverty line by organizing them into self help groups (SHGs), through the process of social mobilization, training, capacity building and provision of income generating assets through a mix of bank credit and government subsidy. The SGSY will be funded by the central and state governments in the ratio of 75:25 (Government of India 2005).

The focus of the programme is on establishing a large number of micro enterprises in rural areas based on the ability of the poor and potential of each area for a sustainable income generation. Due emphasis is being laid on different components such as capacity building of the poor, skill development, training, technology transfer, marketing and infrastructure. The subsidy allowed is 30 percent of project cost; subject to maximum of Rs.7500/-. For SC / ST and disabled persons subsidy limit is 50 percent of project cost or maximum of Rs.10,000/-. For SHGs subsidy is maximum 1.25 lakhs or 50 percent of
project cost. There is no monetary ceiling on subsidy for minor irrigation projects (Government of India 2005).

**Indira Awas Yojana (IAY)**

IAY is a rural housing programme launched by the Government of India. Under this scheme nearly 114.78 lakh houses have been constructed at a cost of Rs.20022.89 crores by March 2004 (Theodore 2005).

**Prime Minister’s Rozgar Yojana (PMRY)**

This scheme was introduced in 1993-94 in selected centres of the country and later to all areas. It is an important credit linked employment generation scheme for the youth which is implemented by District Industries Centres (DICs) and CBs. The scheme provide assistance to educated unemployed youth in the age group of 18-35, with upper age relaxation provided to women, SC/ST and physically handicapped persons whose annual income is below Rs.40,000/-. Subsidy assistance is at the rate of 50 percent subject to maximum of Rs.7500/-. Margin will range between 5 to 16.25 percent such that the subsidy together with margin money will be equal to 20 percent of the project cost. For project with cost up to Rs.1 lakh no collateral security is to be insisted in the case of business and service sectors whereas Rs. 2 lakhs in the case of SSIs.

**Pradhan Manthri’s Gram Sadak Yojana (PMGSY)**

The PMGSY, 100 percent centrally sponsored scheme was launched on 25\textsuperscript{th} December 2000. The main objective of PMGSY is to develop rural roads connectivity. This scheme seeks to provide connectivity to about 1.70 lakh unconnected habitations besides upgradation of some existing rural roads, to prescribed standards by the end of the 10\textsuperscript{th} plan. A cumulative expenditure of Rs.6559 crore was incurred till March 2004 (Government of India 2005).

**Central Rural Sanitation Programme (CRSP)**

Rural sanitation is a state subject. The efforts of the state are supplemented by the Central Government through technical assistance under the CRSP. It was launched in 1986 with
the objective of improving the quality of life of rural people and providing privacy and dignity to women. The concept of sanitation was expanded in 1993 to include personal hygiene, home sanitation, safe water, disposal of garbage and waste water (Government of India 2005).

**Sampoorna Grameen Rozgar Yojana (SGRY)**

It was launched on 25th September 2001 by merging the ongoing scheme of Employment Assurance Scheme (EAS) and the Jawahar Grama Samridhi Yojana (JGSY) with the objective of providing additional wage employment in the rural areas as also food security, along with the creation of durable community assets in the rural areas (Government of India, 2005). An amount of Rs. 9825 crores were provided for rural infrastructure development in 2003-04 as budgetary support and 19,637 number of road works have been completed. In addition 8419 number of road works has been completed during 2003-04 (Theodore 2005)

**Swajal Dhara Scheme (SDS)**

It was flagged off in December 2002 as a new initiative empowering Panchayaths to formulate, implement, operate and maintain drinking water projects (Theodore 2005).

**Watershed Development Programme**

The Department of Land Resource is implementing three area based watershed programs for development of wastelands / degraded lands namely Drought Prone Areas Programs (DPAP), Desert Development Programme (DDP) and Integrated Wastelands Development Programme (IWDP). DPAP was launched in 1973, DDP was launched in 1977 and IWDP was launched in 1989. Since 1st April 1995, the three programs are being implemented on the basis of common guidelines for watershed development (Government of India 2005).

**Hariyali Programme**

The Department of Land Resources launched a new initiative called Hariyali in 2003 with the objective of empowering Panchayath Raj Institutions (PRIs) both financially and administratively in implementation of watershed development programme. Under this
initiative all the ongoing programs like DPAP, DDP and IWDP would be implemented through the PRIs (Government of India 2005).

**People’s Planning Programme (PPP)**

It was introduced on 17th August 1996. ‘Janakeeyasoothranam’ contemplates full participation of people in both formulating, planning and implementation of the so planned activities on a time bound basis. Out of the states annual action plan, 35 to 40 percent are deployed for implementation through Janakeeyasoothranam, for which people from different categories are involved. In this, projects are prepared by giving due weightage to local needs etc; and they are subject to scrutiny and discussion before finalization.

**Self Help Groups (SHGs)**

The SHG linkage programme initiated by NABARD during 1991-92 as a pilot project has taken the shape of a movement and has size pitched up the desired movement. Under this concept, the poor, particularly women are organized into small homogenous groups for taking their own decisions about the saving and credit operations. External lending like bank credit is infused into the groups only after proper evaluation of the functioning of the groups and ascertaining their maturity. The concept has been found to be an effective and successful approach in reaching the unreached and for empowerment of women and poverty alleviation. On cumulative basis, the number of SHGs receiving financial support from commercial banks increased to 538,422 in 2003-04 from 361,061 in 2002-03 with an increase of 49 percent (RBI 2004).

**Vikas Volunteer Vahini Clubs (VVVs)**

The VVV programme introduced by NABARD in the year 1982, offers a forum in the rural areas for banks and borrowers / rural poor to come together, to have a continuous and positive dialogue for initiating appropriate measures to achieve the desired development. The core objective of the programme is propagation of revival of repayment ethics. Promotion of people’s participation is the essence of the programme.
Kisan Credit Card (KCC)

Ensuring timeliness and adequacy of credit to farmers is the most serious challenge faced by the banks while financing this sector. The Financial Sector Reforms (FSRs) ushered in as part of the liberalization of the Indian economy have infused a spirit of competitiveness among the banks in their endeavor for sharpening customer orientation.

KCC is an innovative key product designed and introduced to expand and simplify the credit delivery system of banks by the NABARD. As the pioneering credit delivery innovation, the KCC scheme aims at provision of adequate and timely credit support from the banking system to the farmers for their cultivation needs. It was introduced in 1998 and it was revised in October 2004 to cover term loans for agriculture and allied activities. As on 31st March 2004, CBs, RRBs and Co-operative banks issued KCCs at the tune of 132.43 lakhs, 38.99 lakhs and 242.68 lakhs respectively. So total KCCs issued upto 31st March 2004 came to 414 lakhs (RBI 2004).

Section 2

Role of Commercial Banks in Rural Development

4.2.1 Introduction

Rural financial system is a powerful instrument and a pre requisite in accelerating the developmental activities in rural areas. It operates through two sets of institutions in the organized and unorganized sectors (Nair 2000). The unorganized sector consists of local money lenders, landlords, traders, merchants etc; in which case no effective control can be exercised by the government. They largely function in an autonomous fashion with its own norms and discipline. Of course, the agencies in the unorganized sector in our villages have still a dominating position in rural finance (Joshi 1997, Singh et. al; 2001, Jeromi 2002). They charge exorbitant rates of interest and they continue to exploit the poor rural masses. The situation resulted in the emergence of institutional agencies in rural credit under the control and direction of the government.
In the organized sector there are three streams of institutions - co-operative banks, commercial banks and regional rural banks (Benson 2000; Yadav 2005). These institutional credit agencies in the early 1950s contributed to only 4 percent to total agricultural credit, which is now increased to 65 percent in the country (Singh et. al; 2001). The share of commercial banks in total institutional credit to agriculture is almost 48 percent followed by co-operative banks with a share of 46 percent and RRBs about 6 percent (Mathur 2001). But studies have shown that many of the ordinary people have no access to institutional credit. (Reddy 2000) and Indian banking system has not given due attention to rural banking (Shivamaggi 2000).

4.2.2 Co-operative Banks

Institutional credit entered the rural area in the form of co-operatives in 1904. The co-operative finance is the cheapest and the co-operative banks are the best friends of rural people (Mathur 2001). They provide short term, medium term and long term loans to rural masses (Joshi 1997). The co-operative banking system, today, forms an integral part of the Indian financial system. With a wide network and extensive coverage, these institutions have played an important role in enlarging the ambit of institutional credit by way of inculcating banking habits among the people, especially, the poor in every nook and corner of the country. As on March 31st 2003, there were 1,12,309 PACS with about 120 million members, 16 scheduled state co-operative banks, 339 district co-operative banks for providing short and medium loans and 20 State Co-Operative Agricultural and Rural Development Banks (SCARDBS) and 768 Primary Co-Operative Agricultural and Rural Development (PCARDBS) operative in India\(^1\).

4.2.3 Commercial Banks

It has been universally accepted that Commercial Banks have a vital role to play in the progress of an economy irrespective of its status as developed or underdeveloped (Rajithakumar and Sarangadharan 2003). The All India Rural Credit Review Committee, under the chairmanship of B. Ventkatappah (1966) examined the rural credit system. It

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observed that the co-operative credit frequently fell short of standards of timeliness, adequacy and dependability. It was noted that the co-operatives alone, though they had increased their coverage since 1950, both in terms of membership and finance provided, would not be in a position to meet the increasing requirements of credit. The nationalization of commercial banks in 1969 was, therefore, a landmark in the history of Indian banking and seen as an opportunity to bring these banks in a big way in the areas of agriculture finance to provide a strong background for economic development.

The involvement of commercial banks in agricultural financing was also probed by Prof. D.R. Gadgil Study Group in 1969. According to the recommendations of this group, RBI introduced Lead Bank Scheme in 1969 in unbanked areas of the country ie; rural areas and a new strategy for rural development known as Service Area Approach was introduced in April 1989. Though commercial banks are playing an effective role in rural development, they are faced with a number of problems and a large segment of the rural economy is still beyond the reach of the organized commercial banks (Joshi 1997). To resolve these problems, and fill the gap, the Central Bank organized RRBs by special Acts of the parliament (Regional Rural Banks Act 1976).

4.2.4 Regional Rural Banks (RRBs)

RRBs came into existence in 1975, on the basis of the recommendations of the working group headed by Mr. M. Narasimham with a view to provide banking facilities to the rural masses and extending wide variety of financial assistance to the weaker and poorer sections of the rural community (Naidu 2001). In the last 30 years, RRBs have been active participants in programs designed to provide credit assistance to identified beneficiaries under the new 20 point programme, IRDP and other special programs for rural development. Within about 2 decades of their being set up RRBs have been subject to close examination by a number of expert committees like Bhandari Committee, Basu Committee, M.L. Dantwala Committee, Agricultural Credit Review Committee (Khusro committee 1989) and M. Narasimham committee (Joshi 1997, Mazumdar1998). As on March 31st 2004, there were 196 RRBs in India with 14433 branches in 516 districts. They mobilized deposits of Rs.50,000 crores and the outstanding advances stood at
Rs.22,000 crores (Valsamma 2004). RRBs also facing a number of problems. Most of the RRBs are in losses due to high cost of operations, low productivity and poor recovery of advances (Toor 1998, Deshpande et. al; 1998; Das 1998, Valsamma 2005).

4.2.5 Banks and Rural Development

It is only recently that commercial banks embarked on the voyage of rural development in a big way. The number of commercial banks has increased from 187 in 1981 to 291 in 2004 (Table 4.1).

They are providing short, medium and long term loans to agriculturists directly and indirectly. They have been opening branches in hitherto little known areas and have also liberalized their lending procedures to bring a larger population within their ambit. They provided a major thrust to rural development with a number of schemes like SAA, DIR, LBS, Consortium approach for deployment of credit, formulation of DCPs, Review of Credit Plans etc. These schemes implemented gave a tremendous boost to the government sponsored programmes in poverty alleviation, self-employment generation, crop production etc.

Since July 1991, the Indian banking sector has been witnessing wide range of reforms. The credit policy of the RBI aims at providing a package of measures to ensure adequate support by the banking sector to the revival of output in the economy. Under the overall stipulation of priority sector credit of 40 percent of the net bank credit and the sub target of 18 percent prescribed for agriculture lending, direct and indirect categories of advances to agriculture had been clubbed. However, lending for indirect agriculture should not exceed ¼th of the total agriculture lending. Advances made by banks to SSIs are treated as priority sector advances. To ensure the flow of credit to SSIs it is stipulated that 40 percent of the SSI advances made by each bank should go to cottage, Khadi and village industries and tiny units with investments in plant and machinery up to Rs.5 lakhs.

As on 30th June 2004, out of total 67,097 branches of SCBs, 32,207 branches were functioning in rural areas, apart from 15,028 branches located in semi urban areas (SLBC
The RBI, as per its guidelines on 24th August 1996, established Local Area Banks (LABs) in the private sector in order to give encouragement to rural and semi urban savings and to provide institutional credit to viable economic activities in the local areas. Local banks are supposed to cater to the needs of the local people and to provide efficient and competitive financial intermediation services in the areas of operation (Yadav 2005).

### Table 4.1: Number of Commercial Banks in India

<table>
<thead>
<tr>
<th>Year</th>
<th>No. of Commercial Banks</th>
<th>Scheduled Commercial Banks</th>
<th>Non Scheduled. Comm. Banks</th>
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<tr>
<td></td>
<td>SCBs</td>
<td>RRBs</td>
<td>Total SCBs</td>
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<tr>
<td>1981</td>
<td>187</td>
<td>81</td>
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<td>2004</td>
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The RBI constituted an advisory committee to evaluate the flow of credit to agriculture and related activities from the banking system under the chairmanship of Sri. V.S. Vyas, which submitted its report in June 2004. The recommendations of the committee are important in the context of expanding the outreach of banks and improving flow of credit to the agricultural sector (RBI 2004).

The government announced a package of measures on June 18th 2004 aimed at doubling agricultural credit in three years with a credit growth of 30 percent for 2004-05 (RBI 2004). In pursuant to the announcement, RBI and Indian Bankers Association (IBA) issued guidelines to SCBs and NABARD issued guidelines to RRBs and Co-operative Banks. These include:

- Debt restructuring and provision of fresh loans to farmers affected by natural calamities.
- One time settlement for small and marginal farmers.
- Fresh finance for farmers whose earlier debts have been settled through compromise or write-offs and
- Relief measures for farmers indebted to non institutional lenders.

Although various measures have been taken for expanding credit to the weaker sections of the farming community, the commercial banks have not shown any encouraging performance. This is because agricultural financing has always been a neglected segment in the package of financial sector reforms (Singh and Gill 1998, Baslas and Bensal 2001, Patel 2001, Majumdar 1998). The share of agriculture in total bank credit had steadily increased under the impulse of bank nationalization and reached 18 percent towards the end of 1980s, but thereafter the achievements has been almost completely reversed and agriculture credit share has dipped to less than 10 percent in the late 1990s – a ratio that had prevailed in the early 1970s. Even the number of farm loan accounts with SCBs has declined in absolute terms from 27.74 million in March 1992 to 20.84 million in March 2003 (Shetty 2004). The EPW Research Foundation (2004) also found that the share of bank credit for agriculture showed a declining trend. The branch rationalization policy of the RBI had an impact on the share of rural branches, which declined marginally to 48
percent as at the end of June 2003 from 48.4 percent as the end of June 2002 and the share of urban and metropolitan branches increased marginally from 29.2 percent in 2002-03 to 29.6 percent in 2003-04 (RBI 2004).

Of the total population, agricultural sector of the country has more than 70 percent persons who are marginal and small farmers. Their security position poses serious problems for CBs in lending money for agriculture purpose (Joshi 1998(b)). Due to the vulnerability of the poorer sections of rural people in the society, the powerful people in rural areas have siphoned-off benefits of government schemes lending (Naidu 2001). Low creditworthiness of the weaker section still comes in the way of their getting loans and as such DCPs are not much avail to them. The moneylender in our village, therefore, still has a dominating position in rural finance (Joshi 1998(b); Singh et. al 2001). Further, the Indian banking sector, especially, the PSBs have been facing the big challenge of NPAs (Yeole 2004) and as a result, the agricultural advances of SCBs and PSBs drastically declined in recent years (Bhide et. al; 2002). This is because the rural development schemes became tools in the hands of unscrupulous politicians who literally turned the PSBs into charitable institutions and loans waiver to one section of the borrowers led to other borrowers also demanding similar concessions of tuning will full defaulters (Murali and Sadasivan 2001). These have badly affected the viable function of banking institutions (Joshi 1998(b)). So CBs are facing various problems is rural finance. The very success of rural lending in Indian villages will depend upon the existence of an adequate rural infrastructure to tackle the various problems of farmers and enabling them to realize adequate prices for their products and expediting timely repayment of their loans.
References
Joshi N. C., “Rural Credit and Development – A Fresh Look”, Kurushetra, August 1997, pp. 84-88.