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Dayalal Sankhla
Assistant Professor, Department of Economic Administration and Financial Management, M.B.C. Government Girls College, Barmer, Rajasthan, India

Corresponding Author:
Dayalal Sankhla
Assistant Professor, Department of Economic Administration and Financial Management, M.B.C. Government Girls College, Barmer, Rajasthan, India

Rural credit system in India: Institutional financing

Dayalal Sankhla

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Abstract
A significant amount of qualitative, quantitative, and structural changes has taken place in the institutional framework for the distribution of rural loans since the country gained its independence. The purpose of this article is to investigate the present rural credit system in India in order to determine the extent to which it has been able to satisfy the ever-increasing credit requirements of various rural borrowers. The policy of the government for rural credit has been one of the progressive institutionalizations that has been working toward the goal of providing rural borrowers with credit that is both prompt and appropriate. The conclusion of this article, which is based on data obtained from secondary sources, is that the primary area of concern in rural financial institutions in India is the accumulation of non-performing assets and delayed payments. The authors highly propose that remedial steps be implemented, such as focusing on monitoring and supervision of the end use of credit by the borrowers, rather than just disbursing credit. This is one of the recommendations that the writers make. There are a number of suggestions that have been presented in order to transform the rural financial institutions that are losing money into profitable organizations.

Keywords: Rural credit, rural financial institutions, non-performing assets, cooperatives

Introduction
Providing employment for two thirds of the Indian population, the rural sector is the most significant sector of the Indian economy. By making credit accessible in a timely manner, the role of the rural credit system is very important from the perspective of increasing productivity as well as encouraging investment in agriculture and other sectors that are associated with rural areas. The primary objective of this piece is to investigate the current system that is in place for the provision of credit to rural areas and to determine the extent to which it has been able to satisfy the ever-increasing credit requirements of rural borrowers.

Objective of the Study
In order to achieve the main purpose, the following objectives have been set:
- To assess India's current institutional framework for lending to rural areas.
- To evaluate the operational efficacy of various Rural Financial Institutions (RFIs) in India, such as cooperative banks, commercial banks (CBs), regional rural banks (RRBs), and other RFIs.
- To determine the system's operational limitations and structural flaws using RFIs in India.
- To provide some appropriate recommendations for improvements to India's current rural credit system.

Research Methodology
For the investigation, secondary sources of data were employed. The RBI and NABARD reports served as the paper's primary data source. For the investigation, basic statistical methods were used. Both public and unpublished sources, such as websites, books, journals, magazines, newspapers, RBI annual reports, and research papers, have provided secondary data. For the research, basic statistical methods including averages, percentages, and ratios were used. The relative effectiveness of ground level RFIs in India has been evaluated using a wide range of criteria, including how well they have met rural borrowers' credit needs and how well they have been able to mobilize savings from these areas and provide a branch network.

Institutional framework

Following independence, the institutional framework for granting rural credit saw significant qualitative, quantitative, and structural changes at the national and local levels. During this time, each regional component developed its unique characteristics and contributed to the overall rural finance system. There are two sectors that make up India's current rural credit system: non-institutional and institutional. Professional and agricultural moneylenders, landlords, dealers, commission agents, relatives, and friends make up the non-institutional sector, while co-ops, commercial banks, and regional rural banks make up the institutional sector.

Private agencies provide loans on unfavorable conditions and for unproductive uses; their primary goal is to trap borrowers in a never-ending cycle of debt rather than to boost output. The agriculture subcommittee observes that lenders often turn to and exploit rural borrowers' needs. Therefore, the creation of an institutional framework for lending to rural areas was desperately needed. The goal of the government's gradual institutionalization approach to rural lending has been to provide rural borrowers access to timely and sufficient finance. Table 1 shows the different agencies' respective contributions to the overall amount of rural loans.

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

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

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

Table 1 shows that the non-institutional sector's share of all farmer borrowings has significantly decreased in the area of rural lending, from 93% in 1951–1952 to 39% in 1981 and then to 30% in 2022. At first, co-operative credit societies were essentially India's only institutional source of rural finance. However, as it became clear that many of these societies were neither viable nor potentially viable, the government of India adopted a multi-agency system in 1970, which allowed for the development of both commercial and co-operative banks to meet the expanding needs of the rural sector. With varied degrees of success, commercial banks have experimented in various sections of the country with a variety of alternatives and combinations of tactics and approaches. Creating a pool of technically skilled field officers is one of them. Other strategies include financing via farmer service societies (FSS) and main agricultural cooperative societies (PACS), financing through group finance through the service area approach (SAA), and lead bank schemes (LBS). Established in 1975, Regional Rural Banks (RRBs) provide exclusively to the needs of "target groups" in rural regions, including small and marginal farmers, artisans, craftsmen, reserved castes and tribes, and so on. Since well-off farmers appropriate the majority of the aid supplied by commercial and cooperative banks, while small and marginal farmers get a negligible portion of the overall credit issued by them, this has been observed. Reserve Bank of India (RBI) is in charge of the whole rural credit system's infrastructure. Which direct policy-making authority is within the purview of the RBI when it comes to the distribution of loans to commercial and cooperative banks alike?

Having provided rural credit from top to bottom by organizing, overseeing, and monitoring rural credit in India, the National Bank for Agriculture and Rural Development (NABARD) was established in 1982 as the premier organization to integrate the whole system. In addition, it offers technical advice, staff training, and non-financial assistance to RFIs. Despite a remarkable increase, the rural poor were still unable to use the rural credit system. Few non-governmental organizations (NGOs) and voluntary organizations (VO) known as self-help groups (SHGs) tried to organize the impoverished into unofficial groups and provide funding for them in an effort to improve access for the rural population. There have been recent attempts to establish a formal rural credit system connection between informal groupings. Connecting NGOs and SHGs is one such creative approach that has improved repayment performance while lowering transaction costs.

Performance of Rural Financial Institutions

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

Geographical Coverage by RFIs

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

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

Table 2: Branch Expansion of RFIs

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

***Source*:** Data from RBI and NABARD

Deposit Mobilization by RFIs

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

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

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

***Source*:** Data from RBI and NABARD

Loans and Advances by RFIs

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

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

***Source*:** Data from RBI and NABARD

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

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

***Source*:** Data from RBI and NABARD

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

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

Major Areas of concern of Rural Financial Institutions

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

Non-Viability

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

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

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

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

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

Table 7: NPA Recovery Performance of Rural Financial Institution

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

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

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

Conclusion and Suggestions

Significant advancements have been accomplished in every area regarding the measures that were started to create the rural credit system. In rural regions, a vast network of outlets has emerged for loan issuance, with acceptable geographical coverage. The most underdeveloped areas have been able to get finance via organized sources. Credit provided to agriculture and related rural activities has surged dramatically; small and marginal farms received a portion of the credit extended by RFIs, and credit institutions have begun to play a significant role in India's rural development. A hallmark of India's official credit system is the widespread network of major banks. Formal RFIs are supported in India by a number of criteria, including a multi-agency approach, a vertically integrated organization, a high field staff density, a variety of services, a search for clients, experienced personnel, the lack of a start-up phase, etc. Nevertheless, the primary shortcomings are also insufficient autonomy, less focus on the non-farm sector, inadequate monitoring, political meddling, comparatively high costs linked to the centrally planned credit system, low loan recovery rates, staff members' unfavorable attitudes, and a lack of responsiveness and flexibility.

Strong support should be garnered for the creation of a long-term, successful rural credit system. RFIs and the top organization, NABARD, should work together to raise awareness of the need for such a system. Serious issues with RFIs include significant and ongoing loan default, bureaucratization and politicization, and poor resource efficiency (ACRC Report). The primary worries, however, are with two key goals: the issue of huge overdue fees and the non-viability of RFIs, which call for urgent attention and expeditionary measures. Top-tier organization In order to support quick growth in rural areas, NABARD must take the initiative to revitalize primary level institutions that are inactive or unviable, particularly cooperatives. Politicians' promises to wipe off student loans often foster the mindset of non-payment, which undermines the global recovery environment. Commercial banks have launched a number of initiatives aimed at improving social welfare and the lot of rural impoverished people. They have performed rather well in terms of numbers, but they have had terrible success recycling the money they have loaned. The idea of socialization has also had a negative impact on commercial banks' profitability because of a number of factors, including low margins, extended maturities, and interest rates. The goals of commerce and society should be properly balanced. It has been noted that one of the main factors weakening the rural credit system's financial shortage is the frequency of past-due accounts. In order to enhance RFI recovery effectiveness, it is important to examine past-due accounts and non-performing assets (NPAs). Following a discussion about the issue with RFIs with a few NABARD officials, the following adjustments are thought to be essential for the RFIs' financial sustainability in India.

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