Usha Thorat: Banking in the Hinterland

Keynote address by Ms Usha Thorat, Deputy Governor of the Reserve Bank of India, at the Conference on "Banking in the Hinterland", organised by the Indian Banks Association and Rural Marketing Agencies Association of India, Mumbai, 14 February 2007.

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Ladies and Gentlemen,

It gives me great pleasure to be here this morning to share my thoughts on banking in the hinterland. The theme of my talk today is that there is a huge business opportunity in banks going rural. Rural banking has great potential if banks adopt appropriate approach and suitable strategies – scale up their business levels, achieve capacity utilisation and devise innovative ways to cater to the typical needs of the vast rural sector.

I will divide my address into three parts. In the first part, I shall describe the rural urban divide in banking. In the second part, I will describe some changes that are happening in the rural sector. Finally, I will try and elaborate on the kind of strategies that could be considered for banking in the hinterland.

Part – I: The rural urban divide

Analyses of certain indicators of banking penetration of scheduled commercial banks in the country, including RRBs, amply testify to the rural urban divide existing in their operations/business, as will be seen from the following:

Average population per branch office (APPBO)

The average population served per branch office is an important indicator of banking penetration. The trend in this indicator ever since the last decade is as under:

	1991	2001	2005
Population per branch	13711	15209	15680
Population per Rural branch	13462	15667	16650
Population per Urban branch	14484	14137	13619

While the population per branch has decreased for urban areas, the same has increased for rural areas indicating that branch expansion has not kept pace with the population increase in the rural areas.

Number of accounts per 1000 population

The number of deposit (current plus savings) and credit accounts per thousand population is given below:

	Deposit (C+S) Accounts per 1000 population		Credit Accounts per 1000 Population	
Region/State	**Rural**	**Urban**	**Rural**	**Urban**
Northern Region	338	652	55	71
North Eastern Region	186	281	35	41
Eastern Region	185	413	45	47
Central Region	242	375	45	49
Western Region	263	526	46	121
Southern Region	393	486	136	185
All India	**270**	**483**	**64**	**104**

Source: Computed from BSR 2005 and Census data 2001

It is seen that the deposits (current plus savings) accounts per 1000 population in the rural areas as a whole, is about sixty per cent of the urban areas. North Eastern states, Orissa Bihar and Chattisgarh have particularly low ratio. Similar position is generally evident even in terms of credit accounts per

1000 population. However, Southern states are relatively better off in this regard (Annex 1 and Annex 2).

Number of accounts per branch

The number of deposit and credit accounts per branch in the rural areas is generally lower than the position in urban areas as shown under:

	Deposit (C+S) Accounts per Branch		Credit Accounts per Branch	
Region/State	**Rural**	**Urban**	**Rural**	**Urban**
Northern Region	4130	6677	675	771
North Eastern Region	3716	5340	702	781
Eastern Region	3676	6087	887	693
Central Region	4586	6075	859	797
Western Region	3826	6630	663	1530
Southern Region	4549	5571	1577	2121
All India	**4202**	**6155**	**1000**	**1321**

Source: BSR 2005

Outstanding balances per branch

The deposits and credit outstanding per branch also reflect the rural urban divide.

	Deposit (C+S) per Branch (Amt. Rs Crore)		Credit per Branch (Amt. in Rs Crore)	
Region/State	**Rural**	**Urban**	**Rural**	**Urban**
Northern Region	6.43	25.22	7.19	46.99
North Eastern Region	5.41	21.03	4.99	13.80
Eastern Region	4.99	18.80	3.99	23.62
Central Region	5.26	15.40	4.51	15.15
Western Region	4.67	26.51	7.72	63.77
Southern Region	4.01	14.41	8.73	32.68
All India	**4.98**	**19.92**	**6.37**	**37.94**

Source: BSR 2005

It is seen that deposits per branch in the rural areas is far lower than that in the urban areas, notably states in the North East , Northern and Western region. In terms of credit per branch also, the difference is more pronounced in Northern and Western regions.

Outstanding balances per account

The outstanding balance per account, both deposit as well as credit, reveals the much larger values in urban areas as evident from the following:

	Deposit (C+S) Bal per A/c (Rs 000)		Credit Bal per A/c (Rs 000)	
Region/State	**Rural**	**Urban**	**Rural**	**Urban**
Northern Region	15.56	37.78	106.46	609.72
North Eastern Region	14.56	39.38	70.59	176.85
Eastern Region	13.57	30.88	44.58	341.00
Central Region	11.46	25.35	52.49	190.06
Western Region	12.19	39.99	116.42	416.71
Southern Region	8.82	25.87	55.39	154.08
All India	**11.84**	**32.36**	**63.74**	**287.91**

The average size of a deposit account in the rural areas is about one-third the size in urban areas and ranged from about Rs.7000/-(in Andhra) to about Rs.17,000/- (in Punjab). The divide is as is to be expected sharper in terms of credit per account. The average credit account in rural areas ranged from Rs.19,000/-(in Tripura) to Rs.1.31 lakh (in Haryana).

Share of different credit agencies in the total cash dues of households

The share of different agencies in the total cash dues of rural and urban households reveals the extent of penetration of formal financial sources.

(Share in percentage)

Credit Agencies	Rural Households			Urban Households		
	1981	1991	2002	1981	1991	2002
Institutional	**61.2**	**64.0**	**57.1**	**60.0**	**72.0**	**75.1**
of which						
Co-operative Soc/ Bank	..	21.6	27.3	..	17.2	20.5
Commercial Banks	..	33.7	24.5	..	21.6	29.7
Government	..	6.1	2.3	..	11.1	7.6
Non-Institutional	**38.8**	**36.0**	**42.9**	**40.0**	**28.0**	**24.9**
of which						
Moneylenders*	..	17.5	29.6	..	10.2	14.1
Total	100	100	100	100	100	100

..: N.A.

* The category of moneylenders is the sum of agricultural moneylender and professional moneylender

$ Cultivator households is defined as all rural households operating at least 0.002 hectare of land during the last 365 days preceding the date of survey

Source: Computed from the various decadal All India Debt and Investment Surveys

This table clearly shows that the coverage of banks in the rural areas has fallen from 64 per cent to 57 per cent while, significantly, the share of money lenders has increased from 17.5 per cent to 29.6 per cent in these areas.

Part – II: The rural sector – some interesting pointers

I would like to briefly dwell upon some facts, which bring home the potential of the rural sector:

- The savings rate has increased to nearly 31 per cent in the recent period. Remittances from urban to rural areas are becoming more significant as migration increases. The need for banking facilities – savings, remittances and credit – has increased in rural areas.
- The share of agriculture in GDP has fallen from 43 per cent in 1970s to 20 per cent currently; within this, the share of food grains and cereals has declined from 31.7 per cent to 24.1 per cent and that of commercial crops increased. Within the agricultural sector, the share of fishing and livestock has gone up from 20.3 per cent to 29.3 per cent. Agriculture is getting increasingly diversified as floriculture horticulture and other value added activities gain importance.
- The proportion of rural households, described as low income by National Council for Applied Economic Research (NCAER), has gone down from two thirds in early 90s to 25 per cent currently and those with middle income from one third to 70 per cent. This represents increase of 50 million middle income households in rural areas.
- Retail credit has grown in the last four years by nearly 50 per cent per annum mostly at urban centres. As incomes increase, there is growing demand for retail credit in rural areas that is perhaps being met by the informal sector. Anecdotal evidence suggests that moneylenders in rural areas face more competition from other moneylenders rather than from the banks.
- With the growing rural connectivity and tele-density, a host of non-farm activities are mushrooming in the rural sector. Currently, the rural market accounts for 53 per cent of the Fast Moving Consumption Goods (FMCG) and 59 per cent of the durable market in India. The rural consumers represent more than 50 per cent of the country's `consuming classes'.

Part – III: The way forward – some thoughts

Having discussed the rural urban divide in banking and the potential in rural banking, the question that remains to be addressed is – how can banks meet the challenges of banking in the hinterland?

(i) To start with, I believe, fuller utilisation of existing capacity can itself give huge dividends. Given the existing number of nearly 48,000 rural and semi-urban branches, an increase of loans by rupees one crore per branch could imply additional profits of about Rs.480 crore to the banking system.

(ii) Currently each rural branch services only around 1000 loan accounts. If we assume that a bank branch can serve at least 3000 households, it would imply at the minimum tripling of the business at rural branches This might require redeployment and some increase in staff, especially field staff, and would be more than worth the effort considering the increase in business and profitability that it would result in.

(iii) Banks would need to decide the kind of delivery channels required for meeting the banking and remittance needs of the rural population. Today the branch is not the only way of delivering banking services. All options such as mobile and satellite offices, rural ATMs, smart card and mobile phone based banking, use of intermediaries including SHGs, including post offices need to be explored for penetrating into the rural markets. Several banks have tie-up arrangements with corporates engaged in contract farming. IT solutions can take banking to the remotest corner and cut costs apart from providing valuable databases for furthering business strategies. Whatever be the mode of penetration, it is clear that unless there are well thought out strategies for marketing banking services in the hinterland, banks will be missing emerging opportunities. As mentioned earlier 50 million households in rural areas have moved from low income to high income giving rise to equal number of potentially bankable households. To look at the scope for branch banking and provision of banking services through other delivery channels in rural areas, banks can make use of the research already available on the monthly per capita expenditure centre-wise and district-wise, corroborated by data on consumption patterns for FMCG and mobile phones as also other indicators of expenditure patterns.

(iv) Banks need to have appropriate strategies for rural banking. Rural clientele need savings, remittances, loan and insurance products. When banks think of agricultural credit they generally think of crop loans especially, food crops. The needs of agriculture are, however, getting diversified and the required scale of finance is increasing. There is much more demand for allied activities such as dairy, fishing and livestock, cash crops, besides ancillary activities such as sorting, grading, processing, packaging and transporting to final destinations and markets. Other service sector activities that spin-off the main activities are also growing. This is giving rise to additional credit demand from a variety of new enterprises, besides demand for retail and consumer credit. Are banks geared for the surging credit demand in the rural areas in all sector, particularly allied agriculture and services sector?

The strategies of banks will need to focus on the following:

o *Developing products*

A uniform banking/financial product for the entire country would obviously not work. Products need to be designed and packaged taking into account local culture, customs, language, literacy and social indicators. Also, rural households need to be provided credit in a composite way covering all their needs, including life-cycle needs; the traditional crop loans, term loans, housing loans, consumption loans bouquet may not work. Regional offices of banks may need to be delegated with appropriate powers for product design, while ensuring consistency with Board policies. Banks need to look at the overall cash flow of rural households and fix general credit limits, which could be scaled up depending on new/additional activities taken up.

o *Creating awareness and brand building*

Banks need to consciously evolve strategies for financial education in the rural areas. Products developed for the region will need to be actively marketed in a responsible and effective manner, with top priority at all times being accorded to transparency, customer education and satisfaction.

- *Having the right staff for marketing products*

  In rural lending there is an imperative need for the marketing staff to be knowledgeable about agricultural practices and operations, besides being well acquainted with the features of the products and their suitability to the targeted category of customer. In a sense, providing financial services will also involve providing extension services as a risk mitigant. Hence, banks will need proactive technical officers who can not only provide such services, but also train their field staff. Another very important requirement is relationship management in terms of face-to-face familiarity and continuity of contact. Surely, it is not without reason that the rural folk are comfortable with persons like the postmen and even the local moneylender, with whom they have occasion to regularly interact. Banks would do well to address this need for building up a relationship and rapport with the rural clientele.

- *Use of Information Technology (IT)*

  There are a variety of ways in which IT can be used by banks. Delivery of banking services through IT based solutions, such as mobile phones and smart cards, while keeping costs low, is one huge opportunity for increasing outreach afforded by modern technology that is rapidly innovating. Other uses of IT are in credit risk management and pricing, which require maintaining a comprehensive computerised data base – this can be used for a variety of purposes, such as marketing, credit scoring, pricing, credit monitoring including rating migration and devising appropriate internal control systems, etc. There is clearly a need to have credit information companies across the entire country; the huge externalities associated with having comprehensive credit records can be derived for more efficient financial intermediation. With appropriate IT solutions in place and suitable field staff, banks can also provide market insurance and capital market products for increasing their non funded business.

- *Developing and using risk mitigants*

  The three important risks identified in agricultural lending are yield risk (or input output risk), calamity risk and price risk. Banks will need to aim at minimising these risks if they have to deliver affordable credit to agriculture. Extension work, including proper advice on use of fertiliser and pesticides, ensuring quality seeds and inputs are activities that minimise yield risk. Enterprises providing such services would need to be supported by banks and actively encouraged. Calamity risk minimisation involves insurance of crops and assets, including of livestock/cattle and fisheries. While restructuring of loans can provide more time for repayment, repeated rescheduling could lead to instalments ballooning beyond the repayment capacity. Banks will have to evolve policies to address this issue while providing vulnerable groups opportunities to engage in activities that supplement the household income at times of natural calamities. Development of appropriately priced insurance products is obviously a challenge especially id such insurance has to be affordable and sustainable. Price risk in agriculture is inherent, having regard to the nature of agricultural operations where supply cannot respond to prices immediately. Hence, price support policies have been followed over the years. A more recent development is the futures markets, which can provide opportunity to hedge risks. However, the players in these markets are mostly traders and speculators. There is a need to find ways in which commodity markets can be used to provide price support to farmers.

- *Micro finance*

  A separate strategy for micro finance may have to be evolved, as this involves providing low income families with access to banking. Invariably banks have found it advantageous to partner with community based organisations and NGOs working in the area for micro-finance. Promoting SHGs, nurturing them and transforming them from micro-finance to micro enterprise is something many banks are already engaged in. Banks could explore the possibilities of working with the State governments by offering them efficient technology solutions, such as smart cards for distribution of budgeted allocations for NREGP, pension payments and various other social sector expenditures. As some of you may be aware, a pilot project is under way in Andhra Pradesh (AP), where the AP government will tie up with banks, who will offer smart cards to BPL families /pension recipients /NREGP workers for disbursements of wages, pensions and other benefits. These smart cards can be operated at village level through VOs – federated SHGs registered as cooperatives – that are eligible to be used as business correspondents by banks. It is expected that as the SHG members get used to the smart cards, there will be return flow of funds as they use their bank accounts for savings. The cards could also be used as normal debit cards at merchant establishments.

- *Regional Rural Banks (RRBs) as partners*

  One in every three rural/semi urban branch in the country is an RRB branch. Moreover, the staff members of RRBs belong to the region and have knowledge of local language and customs. These are significant strengths and need to be leveraged by sponsor banks, who should view RRBs as their partners in rural banking. The initial costs for up scaling technology and skills in the RRBs will be amply rewarded by the benefits that would accrue in due course.

Conclusion

Competition in urban areas is squeezing bank margins. Even though agriculture contributes only 20 per cent of GDP, the rural population constitutes 70 per cent of population and as reported accounts for 60 per cent of consumer durable market. This implies that there is an untapped business potential for aggressive banking in the rural areas. The challenge lies in locating these areas and providing them with the financial services through appropriate delivery channels and products. I am sure that the banks with their extensive network of branches in the rural areas will be able to leverage their presence and meet these challenges.

My thanks to the Indian Banks Association and Rural Marketing Agencies Association of India for giving me this opportunity for delivering the keynote address at this conference. I am sure that the day's deliberations will bring new insights to banking in the hinterland. I wish the conference every success.

Thank you.

Annex-I: State-wise Deposits (Current & Savings) of Scheduled Commercial Banks (incl. RRBs)

(March 2005)

Region/State	A/c per '000		A/c per Branch		Amt per Branch*		Amount per A/c**	
	Rural	*Urban*	*Rural*	*Urban*	*Rural*	*Urban*	*Rural*	*Urban*
Northern Region	***338.3***	***652***	***4130.3***	***6677***	***642.6***	***2522.4***	***15.6***	***37.78***
Haryana	365.7	589	4752.0	6668	727.7	1749.2	15.3	-
Himachal Pradesh	487.8	-	3313.9	-	569.3	-	17.2	
Jammu and Kashmir	315.3	480	3523.6	6076	742.6	2116.5	21.1	34.83
Punjab	622.6	622	5290.5	5853	904.2	1463.9	17.1	25.01
Rajasthan	198.5	376	3287.3	5727	365.1	1241.3	11.1	21.68
Chandigarh	1006.7	1411	4416.1	5382	1215.2	1805.1	27.5	33.54
Delhi	720.7	1001	8570.0	7869	2034.2	4171.2	23.7	53.01
North Eastern Region	***186.0***	***281***	***3716.3***	***5340***	***541.2***	***2102.7***	***14.6***	***39.38***
Arunachal Pradesh	249.3	0	3184.4	-	974.9	-	30.6	-
Assam	197.7	333	4320.8	5427	541.9	2122.8	12.5	39.12
Manipur	71.6	203	2368.0	5044	321.2	2164.2	13.6	42.90
Meghalaya	170.6	380	2121.9	4776	428.3	2241.7	20.2	46.94
Mizoram	105.4	140	1209.3	5594	236.8	2384.4	19.6	42.62
Nagaland	133.7	0	2996.4	-	876.1	-	29.2	-
Tripura	184.2	365	3251.5	5510	509.6	1721.9	15.7	31.25
Eastern Region	***185.2***	***413***	***3676.2***	***6087***	***498.8***	***1879.6***	***13.6***	***30.88***
Bihar	155.0	341	3626.6	6234	483.5	1898.9	13.3	30.46
Jharkhand	222.1	282	3700.3	6623	695.6	2247.6	18.8	33.93
Orissa	189.5	277	3055.3	4133	383.5	1181.6	12.6	28.59
Sikkim	296.4	0	2589.7	-	684.2	-	26.4	-
West Bengal	205.7	511	4156.5	6372	497.2	1965.3	12.0	30.84
A & N Islands	574.6	0	4176.6	-	1075.8	-	25.8	-
Central Region	***241.8***	***375***	***4586.0***	***6075***	***525.7***	***1540.0***	***11.5***	***25.35***
Chhattishgarh	151.4	286	2968.3	5548	481.1	1844.9	16.2	33.25
Madhya Pradesh	174.7	315	2901.5	5675	368.2	1283.8	12.7	22.62
Uttar Pradesh	266.2	412	5625.4	6323	579.0	1606.4	10.3	25.41
Uttaranchal	440.8	405	3763.3	5528	695.9	1629.4	18.5	29.48
Western Region	***263.3***	***526***	***3826.4***	***6630***	***466.5***	***2651.3***	***12.2***	***39.99***
Goa	2587.0	0	4976.0	-	930.7	-	18.7	-
Gujarat	294.8	448	3954.2	5861	528.2	1530.6	13.4	26.12
Maharashtra	215.2	572	3591.6	6960	362.9	3131.6	10.1	45.00
D & N Haveli	555.7	0	7871.8	-	1889.6	-	24.0	-
Daman & Diw	906.2	0	5705.5	-	1728.9	-	30.3	-
Southern Region	***392.8***	***486***	***4548.7***	***5571***	***401.3***	***1441.4***	***8.8***	***25.87***
Andhra Pradesh	309.6	518	4651.1	5764	324.8	1336.6	7.0	23.19
Karnataka	350.1	547	3738.0	5288	324.2	1628.8	8.7	30.80
Kerala	683.1	427	5593.0	4835	548.0	985.6	9.8	20.38
Tamil Nadu	377.3	439	4406.1	5882	431.0	1524.5	9.8	25.92
Lakshadweep	729.7	0	2727.9	-	835.8	-	30.6	-
Pondicherry	792.7	529	6295.1	6997	843.0	1629.7	13.4	23.29
All India	***269.6***	***483***	***4201.8***	***6155***	***497.6***	***1992.0***	***11.8***	***32.36***

*: Amount per branch is in Rs. lakhs. **: Balance per account is in Rs.'000

Source : Banking Statistical Returns, Reserve Bank of India, 2005

Annex-2: State-wise Outstanding Credit of Scheduled Commercial Banks (Incl. RRBs)

(March 2005)

Region/State	A/c per '000		A/c per Branch		Amt per Branch*		Amount per A/c**	
	Rural	*Urban*	*Rural*	*Urban*	*Rural*	*Urban*	*Rural*	*Urban*
Northern Region	***55.29***	***75.26***	***675.03***	***770.76***	***718.63***	***4699.53***	***106.46***	***609.72***
Haryana	59.19	54.57	769.04	617.90	1011.18	2144.36	131.49	347.04
Himachal Pradesh	74.25	-	504.42	-	776.24	-	153.89	-
Jammu and Kashmir	35.33	57.23	394.79	724.17	431.56	2806.67	109.32	387.57
Punjab	76.12	60.57	646.88	570.10	759.66	2091.44	117.44	366.86
Rajasthan	47.75	46.54	790.63	708.09	517.97	2214.74	65.51	312.78
Chandigarh	136.02	172.08	596.67	656.50	2907.33	5390.61	487.26	821.12
Delhi	27.51	125.06	327.10	983.02	3332.30	8408.63	1018.74	855.39
North Eastern Region	***35.16***	***41.04***	***702.48***	***780.58***	***495.90***	***1380.43***	***70.59***	***176.85***
Arunachal Pradesh	40.88	-	522.13	-	529.49	-	101.41	-
Assam	30.28	47.72	661.70	777.58	461.82	1222.11	69.79	157.17
Manipur	15.57	38.85	514.76	963.57	320.60	1077.70	62.28	111.84
Meghalaya	41.04	51.15	510.54	643.08	1086.77	2798.33	212.87	435.14
Mizoram	56.79	29.89	370.39	1198.36	353.58	2020.55	95.46	168.61
Nagaland	24.44	-	547.73	-	417.74	-	76.27	-
Tripura	88.42	45.79	1561.01	690.83	303.29	875.14	19.43	126.68
Eastern Region	***44.70***	***46.96***	***887.50***	***692.80***	***395.64***	***2362.43***	***44.58***	***341.00***
Bihar	31.98	38.21	748.31	698.17	278.22	851.82	37.18	122.01
Jharkhand	45.54	28.29	758.66	664.25	308.94	1773.78	40.72	267.03
Orissa	71.76	66.03	1156.80	983.51	655.67	1949.31	56.68	198.20
Sikkim	61.66	-	538.65	-	672.55	-	124.86	-
West Bengal	45.86	51.02	926.71	635.97	375.96	2927.89	40.57	460.38
A & N Islands	76.26	-	554.30	-	966.39	-	174.34	-
Central Region	***45.26***	***49.23***	***858.50***	***797.14***	***450.66***	***1515.00***	***52.49***	***190.06***
Chhattisgarh	33.27	34.36	652.07	667.24	399.96	2261.93	61.34	339.00
Madhya Pradesh	42.06	55.30	698.56	996.06	497.44	1800.58	71.21	180.77
Uttar Pradesh	46.71	48.19	986.95	739.25	433.99	1340.68	43.97	181.36
Uttaranchal	69.16	49.34	590.47	673.42	480.46	1366.14	81.37	202.87
Western Region	***45.61***	***121.36***	***662.81***	***1530.40***	***771.65***	***6377.29***	***116.42***	***416.71***
Goa	218.78	-	420.82	-	1004.27	-	238.65	-
Gujarat	49.59	41.57	665.25	544.04	748.07	2894.39	112.45	532.01
Maharashtra	41.25	160.42	688.44	1953.17	747.42	7870.11	108.57	402.94
D & N Haveli	35.26	-	499.50	-	3370.58	-	674.79	-
Daman & Diw	61.38	-	386.44	-	2258.00	-	584.31	-
Southern Region	***136.16***	***185.07***	***1576.88***	***2121.00***	***873.41***	***3267.98***	***55.39***	***154.08***
Andhra Pradesh	136.11	93.22	2044.76	1037.07	926.50	2593.53	45.31	250.08
Karnataka	103.11	203.77	1100.83	1970.65	873.75	3138.45	79.37	159.26
Kerala	166.81	87.81	1365.75	994.38	780.39	2362.63	57.14	237.60
Tamil Nadu	148.10	273.86	1729.47	3666.07	897.28	4360.05	51.88	118.93
Lakshadweep	78.08	-	291.89	-	248.22	-	85.04	-
Pondicherry	187.07	90.17	1485.61	1192.90	1015.34	1667.06	68.35	139.75
All India	***64.16***	***103.62***	***999.94***	***1320.99***	***637.41***	***3793.74***	***63.74***	***287.19***

*: Amount per branch is in Rs. lakhs. **: Balance per account is in Rs.'000
Source : Banking Statistical Returns, Reserve Bank of India, 2005