A Study on Challenges of Banking in Rural India

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Abstract :

Banking plays a vital role in economic development of every country by providing credit and creating financial awareness. But as we are aware, despite all the efforts that have made, a huge section of the rural population is still out of the banking net. Rural India has huge potential for development and provides tremendous business opportunity for the banks.

However there is a lot of gap in banking activities in rural areas. Most of the population in India are living in villages and agency areas. Literacy rate in villages is very low and income levels of the people are also very low. In several areas minimum needs of the people are not fulfilled. Most of the villages do not have bank branches in rural India.

Due to several reasons banking services available mainly to urban areas. Rural areas in India are not covered properly. As many of the banks cater their services to industrialists and profitable areas; agriculturists, artisans, handworkers, labourers and other weaker sections were neglected.

Rural development occupies a significant place in the overall economic development of the country. But the overall position of Rural Banking in India is not quite encouraging. There is a need to introduce innovative models in product design and methods of delivery through better use of technology and related processes to reach all the rural folk.

Key Words : Rural Development, Rural Banking, Nationalisation, Lead Bank, Financial Inclusion

Introduction :

Rural banking is the process of conducting banking transactions out in the country where bank branches are too far away to be of use. Rural banking is popular for very small towns and farmers who live far away from areas of larger population and cannot make the drive to these locations whenever they need to use banking services. Typically, an agent of the bank will visit these rural locations and offer to make transactions in an official capacity.

Rural bank is a vehicle of financial inclusion, exists solely to service the specific financial needs of a people that survive on farming and animal husbandry in Indian villages. In a social sense, a rural bank enters the daily lives of its customers and becomes a partner in their well-being and distress. Financial Inclusion" and "Rural Banking" are often used interchangeably to denote the mandate of reaching financial services to the huge unbanked masses of rural India.

Objectives of the Study :

i. to study the challenges of rural banking
ii. to suggest for revitalizing rural banking

Government Initiations for Developing of Rural Banking in India :

Rural banking in India started since the establishment of banking sector in India. Rural Banks in those days mainly focused upon the agro sector. Regional rural banks in India penetrated every corner of the country and extended a helping hand in the growth process of the country.

As per All India Rural Credit Survey Committee recommended the creation of State Bank of India by amalgamating certain state-owned banks with Imperial Bank. Accordingly the Imperial Bank was nationalised and renamed as SBI in 1955. While enacting the State Bank of India Act in 1955, the objective was stated to be the extension of banking facilities on a large scale, more particularly, in rural and semi-urban areas. SBI, therefore, became an important instrument of extending rural credit to supplement the efforts of cooperative institutions. In 1969, 14 major commercial banks were nationalised with the objective of "control the heights of economy". The nationalised banks thus became important instruments for advancement of rural banking in addition to cooperatives and State Bank of India.

The RBI introduced the lead bank scheme in December 1969 to fill the credit gap in a particular district by allocating the responsibility to a particular Lead Bank. One of the dimension of lead bank scheme is accelerating the development of the backward and the underdeveloped areas of the district.

The Narsimham Committee conceptualised the creation of Regional Rural Banks in 1975 as a new set of regionally oriented rural banks which would combine the local fell and familiarity of rural problems. RRBs supposed to evolve as specialised rural financial institutions for developing the rural economy by providing credit to small and marginal farmers, agricultural laborers, artisans and small entrepreneurs.

National Bank for Agriculture and Rural Development (NABARD) was established by an act of parliament on 12th July 1982 to promote sustainable and equitable agricultural and rural prosperity through effective credit support, related services and other innovative initiatives.

On February 22, 2013 RBI has issued Guidelines for Licensing of New Banks in the Private Sector in which every bank is bound to open at least 25 per cent of its branches in unbanked rural centres (population upto 9,999 as per the latest census)

Rural banking has become integral to the Indian financial markets with a majority of Indian population still living in rural or semi-urban areas. Government of India and the Reserve Bank of India have been continuously working to achieve complete financial inclusion i.e. timely and sufficient access to financial services and credit at an affordable cost, in the vast expanse of our country. Pradhan Mantri Jan Dhan Yojana is one of the recent initiatives by the new government which has definitely contributed to bring banking to every household.

In this way several measures have been taken by RBI and Govt. of India to stimulate banking activities in rural India.

Challenges of Rural Banking :

Lack of accessibility is a major problem to all those people who live in geopolitically isolated regions. As most of the commercial banks are located in the vicinity of cities, people in rural areas have a geographical barrier in accessing banks. Lack of physical and social infrastructure in rural India is a key issue impacting access to formal financial services. The average distance to a branch in India is approximately 3.8 KMs. This lack of banking access might also make it difficult for people to save up large sums or obtain credit for lumpy purchases such as start-up costs for a business, agricultural inputs, or even preventative health products. Even if access to formal banking is provided to rural customers, there is no guarantee that these services will be used. According to a study conducted by the World Bank, many households, even in developed countries, choose not to have a bank account as they do not engage in many financial transactions they collect wages in cash, spent in cash and do not wish to be burdened by a bank account.

Access to formal financial services also requires documents of proof regarding a persons' identity, income etc. The poor people do not have these documents. They are unable to show their self identification documents during the opening of a bank account or during taking a loan. Many people are unaware of the banking terms and conditions laid down from time to time. They may also subscribe to the services initially but may not use them as actively as others because of high distance between the bank and residence, poor infrastructure etc.

Since rural banks are generally not within an accessible area customers are likely to spend an entire day to travel to a bank branch which is open between 10:00 am and 5:00 pm. Most of the rural customer are likely to forgo a day’s wage to reach and transact with branch. While some banking transactions could be done over phone, this is rarely an option in a country with such low rural internet density.

As the level of education in rural areas rises and affluence spreads, customers will start seeking efficient, quicker and low cost services. As the financial system diversifies and other types of financial intermediaries become active, in rural areas, savers would turn towards mutual funds or the savers themselves decide to diversify part of their financial surpluses into equities and debentures as also other fixed income securities. The bulk of bank deposits in the rural areas are currently longer term deposits and as these come down, there would be a distinct shortening of the average maturity structure of bank deposits with an increase in asset liability mismatches. The spreads that the banks now enjoy will progressively shrink making it more difficult for them to survive.

Financial awareness has to be spread amongst the excluded masses that are illiterate and poor. For this, evolving an appropriate Business Model & an Efficient Delivery Mechanism is the major challenge for banks.

Access to basic banking services in rural areas remains limited, and lags far behind even formal bank account makes it more difficult for people to save, they will be unlikely to have enough saved up to cope with unexpected emergencies such as household illness. When such shocks occur, rather than withdraw money or take a loan from the bank, people might have to take much costlier actions. A closely related option which has received a substantial amount of recent attention is “mobile money,” in which people can transfer, deposit, and withdraw money using their cell phone. Another approach is a “bank on wheels” in which a vehicle visits a town at a regular interval for people to make transactions. A less glamorous approach would be to simply build more ATMs or bank branches.

Behavioral aspects Research in behavioral economics has shown that many people are not comfortable using formal financial services. The reasons are difficulty in understanding language, various documents and conditions that come with financial services etc.

There is lack of information about the role and function of banks, banking services, products, and interest rates, etc. stop people from including themselves in mainstream banking. They feel insecure to see officers at their place, they fear that they might rob them of their money.

When banks set up small centres, or camps, for opening accounts, villagers thronged after hearing rumours that the government would give away money to account holders. Hence people open accounts hoping to get free money, which if they don’t get will make them feel cheated. They might think banks rob their money.

Various commercial banks across the globe levy transaction charges on credit or debit transactions, on over usage of banking services, on cheque book issuance etc. Though the formal banking system offers loans at interest rates lower than informal banking systems, the time taken for a loan to be sanctioned is high which increases uncertainty and opportunity cost. In addition, the customer needs to pay almost 10% of the loan amount in bribes and eventually receives an amount that is less than what was applied for. Therefore, while the interest rates are usurious in the informal financing system, rural customers still resort to this channel because the waiting time to receive the loan is negligible and there are no indirect costs or commission. Banks also insist on collateral security which many rural poor cannot afford.

There is also a problem of regional imbalance in banking facilities provided by banks. They are creating this problem by concentrating their branches in some specific states and districts and loose other prospective group of customers. Many rural banks are suffering from the problem of heavy loans because of low repaying capacity of their customer, untrained staff, low level of deposits and heavy sanction of loan without checking the creditworthiness of their customers. These banks have still not played a significant role in poverty alleviation of the country. Although various efforts have been made in this regard but lack of economic infrastructure, poor marketing strategies, poor knowledge of customers, low production, low awareness about savings have created many hurdles for banks.

RRBs are facing the problem of inadequate finance. They are dependent on NABARD to collect finance for their further operation. Poor rural people are unable to save anything due to poverty and low per capita income. The low level of saving of these customer create obstacle for RRBs to collect sufficient deposits. High overdues and poor recovery of loan is one of the biggest concern affecting the functioning of RRBs. Reasons being poor access of granting loan, insufficient and untrained staff, unproductive or less productive use of credit, inadequate production, poor marketing facilities and improper channel of recovery system. Lack of proper co-ordination between RRBs and other financial institution like commercial banks, NABARD and other co-operative bank has badly affected the performance of these banks.

As more and more intermediaries entering into rural areas with greater level of technology, traditional banking business will come under pressure. In order to face the competitive pressures being exerted by the recently set up market efficient banks, banks which have extensive branch network in most of the existing and potential rich rural and semi-urban areas may have to provide such services.

Financially remunerative farming and the real estate boom of the past decade has made many farmers in an attractive proposition for bankers. The commercial banks, Regional Rural Banks are found in rural pockets of our country to help the rural people for their all round development. Rural banking is rightly called as an engine of rural growth. Therefore, there is need to develop a profitable model of rural banking.

The banker offers almost everything from a plain savings product, to loans for businesses and wealth management advice to the rural population and creating new strategies to woo rural customers. The government seems to be instrumental in spreading the branches of regional and rural banks at grass root level to provide such banking service to the really needy rural people. In this context, Low savings balances, small transaction sizes and the large number of customers makes it financially unviable for banks to be physically present and serve them.

Lower financial literacy and the technology lag makes the basic financial services even more difficult. The problem is compounded by poor infrastructure as regards power supply and internet connectivity.

Suggestions :

Banks should conduct training sessions to explain to villagers why holding an account is important, and how people can learn to save and invest money in various ways. They also could encourage villagers to look at possibilities for their small businesses.

The number of rural branches should be increased rather than reduced, they should be encouraged to develop more sophisticated methods of credit delivery to meet the changing needs of farming. There should be greater coordination among district planning authorities, panchayati raj institutions and the banks operating in rural areas.

There is increasing recognition that, the spread of literacy and generation of growth impulses in the rural sector would be very significant factors in enhancing effective supply and reducing true cost of rural credit. The access to financial services and Financial Education must happen simultaneously. It must be continuous, an ongoing process and must target all sections of the population.

For the spread of virtual-banking and SMART cards to rural areas, it is essential that electric power and telecom connectivity are continuous and supplies do not drop especially during the hours when a bank's transactional activity is at relatively high levels. The banks could, under such assured supply conditions acquire the required banking software and also put in place the necessary networking for providing anywhere banking facilities in rural and semi-urban areas.

Conclusion :

Rural development occupies a significant place in the overall economic development of the country. The rural banks / branches are expected to play a vital role in providing banking services to meet the increased expectations of their customers in rural areas. But the overall position of Rural Banking in India is not quite encouraging. There is a need to introduce innovative models in product design and methods of delivery through better use of technology and related processes to reach all the rural folk. Provision of diverse financial products and services in the rural areas would enhance income to banks and help in rural development.

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