Journal of Rural Development, Vol. 31, No. (1) pp. 43 - 60
NIRD, Hyderabad.

RURAL BANKING SCENARIO IN INDIA AND THE OPPORTUNITY FOR COMMERCIAL BANKS

*Manoj Kumar Joshi**

ABSTRACT

This study examines the present state of banking services and the potential demand for such services in the rural areas of India. It analyses the emerging favourable opportunities that can motivate commercial banks to open rural banking centres. The study also gives an account of the various innovative banking models that can be implemented with the help of electronic devices, and with the active participation of local individuals. These models in contrast to the traditional brick and mortar model, have the potential to not only reduce the operating costs of the banks but also make available, the banking services and products at the door-step of rural masses.

Majority of people in India live in rural areas. However, rural population have limited access to formal banking services and products because there is no significant development of banking infrastructure in these areas. They face financial exclusion and hence have no other choice but to depend on informal credit sources. However, increase in rural employment opportunities, rise in the rural middle class population and the penetration of wireless telecommunication facility have opened up a vast market potential that can be utilised by the commercial banks to extend their services and products to the unbanked rural areas. Banks can develop innovative banking models by taking advantage of Information and Communication Technology (ICT) and by involving rural masses in the capacity of Business Correspondents (BCs) and Self-Help Groups (SHGs). These models would not only promote the goal of financial inclusion in a big way but also help in channelling the savings from rural areas towards the mainstream economy.

Introduction

One can experience the pulse of India–a very vast land with varied languages and religious and cultural diversity–only in its villages. Based on 2001 census[1], about 72 per cent of India's population are living in rural areas. People residing in urban and rural areas may have different kinds of needs and priorities but the need for financial services is common to both of them. This is because any individual's livelihood and occupation are dependent upon the availability of money at the right time and at the right place. Commercial banks in India can be divided into two types: Scheduled Commercial Banks and Non-scheduled Commercial Banks. The various categories of scheduled commercial banks are

* Faculty Member, (ICFAI Business School), IFHE (ICFAI Foundation for Higher Education), Deemed-to-be University, Hyderabad. E-mail : manoj.kumarjoshi@gmail.com

public sector banks, private sector banks, foreign banks and Regional Rural Banks (RRBs). Public Sector Banks (PSBs) are the State Bank of India (SBI) and its seven subsidiaries and the nineteen nationalised banks. These banks are managed and controlled by the government by having majority (i.e. 51 per cent or more) shareholding in them. Private sector banks are those banks which have been incorporated in India but their ownership is in the hands of private business houses and individuals. Foreign banks are those which have been incorporated in other countries but have their branches in India. They conduct business by obtaining license from Reserve Bank of India (RBI), which is the central bank of the country.

RRBs are established by Government of India (GoI). Their ownership capital is provided jointly by GoI (50 per cent), a public sector bank in the capacity of a sponsor (35 per cent) and a concerned state government (15 per cent). These banks cover rural and semi-urban areas with their area of operation limited to just one or two districts of a state. The primary purpose of establishing these banks is to provide institutional credit to farmers, agricultural labourers and artisans from rural areas. A non-scheduled commercial bank is a banking company, defined in clause (c) of section 5 of the Banking Regulation Act, 1949 (10 of 1949) and it is not included in the 2nd schedule of the RBI Act. Presently there are only four such banks in India.

Methodology

Objectives of the Study : The paper is based on secondary data. It has four objectives:

1. To analyse the present state of banking services in rural and semi-urban areas.
2. To identify the rural banking opportunities for the commercial banks.
3. To examine the extent of financial inclusion achieved in India.
4. To describe innovative banking models, feasible in rural areas.

The present state of banking services in rural areas and the volume of credit and debit available in those areas is examined with the help of various reports published by the Reserve Bank of India (RBI). The economic conditions of the rural masses and the extent of financial inclusion are studied with the help of reports of the Planning Commission, the National Sample Survey Organisation (NSSO), the union budget and the economic survey reports. The Reports of National Bank for Agriculture and Rural Development (NABARD) are used to examine the combined role of banks and Self-Help Groups (SHGs) in promoting financial inclusion. The features of various banking models have been discussed with the help of different reports, articles and illustrations. Simple statistical tools like percentages and mean are used to compare, analyse and draw conclusions from the numerical data presented in various tables.

Spread of Banking Operations

RBI has classified banking centres from Tier 1 to Tier 6 based on the population. It has also classified banking centres into Rural, Semi-urban, Urban and Metropolitan centres based on the population groups. This classification, based on 2001 population census is shown in Table I.

Table 1 : Tier-wise Classification of Centres Based on Population

(i) Classification of centres (tier-wise)	Population (as per 2001 Census)
Tier 1 -	1,00,000 and above
Tier 2-	50,000 to 99,999
Tier 3-	20,000 to 49,999
Tier 4-	10,000 to 19,999
Tier 5-	5,000 to 9,999
Tier 6-	Less than 5,000
(ii) Population-group wise classification of centres	Criteria
Rural centre	Population up to 9,999
Semi-urban centre	from 10,000 to 99,999
Urban centre	from 1,00,000 to 9,99,999
Metropolitan centre	10,00,000 and above

Source: Reserve Bank of India.

To increase the penetration of banking services in unbanked[2] centres, RBI has relaxed its rules. Under new rules, domestic scheduled commercial banks (other than RRBs) need not take prior permission from RBI for opening branches in Tier 3 to Tier 6 centres (where population is up to 49,999), subject to satisfying certain requirements. This also applies to starting of branches in rural, semi-urban and urban centres in North-Eastern States and Sikkim.

Like their urban counterparts, rural folks also need the services of a bank to fulfil their financial needs and commitments. But a majority of rural people are dependent on private moneylenders and other informal sources due to the non-availability of institutionalised credit facilities. In his speech on "Financial Inclusion : Challenges and Opportunities"[3], Dr. D.Subbarao, Governor, RBI has said that in India there are 600,000 habitations out of which only 30,000 have a commercial bank branch. Table 2 shows the percentage of total earners residing in urban and rural areas, having a bank account under different slabs of annual income.

Table 2 : Earners having a Bank Account-2007

(Percentage of Total Earners)

Annual Income (₹)	Urban (%)	Rural (%)	All India (%)
<50,000	34.1	26.8	28.3
50,000 – 100,000	75.5	71.2	73.0
100,000 – 200,000	91.8	87.4	89.9
200,000 – 400,000	95.5	93.6	94.9
>400,000	98.0	96.3	97.6
All income slabs	61.7	38.0	44.9

Source : Presentation by Dr. K. C. Chakrabarty, Deputy Governor RBI, at 20th SKOCH summit 2009, Mumbai on July, 17th 2009.

It can be seen from Table 2 that only 44.9 per cent of total earning population and 38 per cent of rural masses who are earning, have a bank account, across all income slabs. Table 3 shows the sources of loans for the earning individuals based on different annual income slabs. It is obvious that moneylenders are a significant source of loans (when compared to banks) for people having income of less than ₹ 50,000 per annum.

Table 3 : Sources of Loans

(Percentage of Indebted Earners)

Annual Income (₹)	Banks	Moneylenders	Other Institutional & Non-institutional Sources	Total
<50,000	13.0	34.9	52.1	100
50,000 - 100,000	34.5	19.6	45.9	100
100,000 - 200,000	49.3	12.0	38.7	100
200,000 - 400,000	51.6	11.8	36.6	100
>400,000	62.8	5.5	31.7	100

Source : Same as given in Table 2.

Shri S.C. Gupta committee (constituted by RBI in May 2006) in its report on reviewing legislation on moneylending, has noted that the interest rate charged by informal credit providers ranged from 12 to 150 per cent per annum. The report further notes that these credit providers do not follow the standardised practices for interest collection. On the other hand, formal financial institutions have put in place cumbersome documentation procedures for the sanction of credit. In addition, they do not have personal bonding with the customers as is the case with the moneylenders. Farmers with less than one hectare of land face financial exclusion and thus have no alternative but to depend on the moneylenders who provide credit for all purposes including consumption. This is not the case with banks which provide credit only for some well-defined purposes.

The data provided by NSSO through its All-India Debt and Investment Survey (59th round) indicate that rural households are indebted to an extent of 63 per cent of the total outstanding debt of the country as on June, 2002. The survey further points out that the professional moneylenders account for 19.6 and 13.2 per cent of the debt in rural and urban areas, respectively. Commercial banks and cooperative societies are primary sources of debt in both urban and rural areas, accounting for about 51 per cent of the total debt.

Table 4 presents the data related to number of scheduled commercial banks and the number of their offices in rural, semi-urban, urban and metropolitan centres and also the population served per bank office from 2000 to 2009.

Table 4 : Statistics Relating to Commercial Banks

Indicators	March 2000	March 2001	March 2002	March 2003	March 2004	March 2005	March 2006	March 2007	March 2008	March 2009
Number of Commercial Banks	297	301	298	294	291	288	222	183	175	170
(a) Scheduled Commercial Banks	297	296	294	289	286	284	218	179	171	166'
of which: Regional Rural Banks	196	196								
	196	196	196	196	133	96	91	86		
(b) Non-Scheduled Commercial Banks	--	5	4	5	5	4	4	4	4	4
Number of Offices of Scheduled Commercial Banks in India*	65412	65919	66190	66535	67188	68355	69471	71839	76050	80547
Rural	32734	32562	32380	32303	32121	32082	30579	30551	31076	31667
Semi-urban	14407	14597	14747	14859	15091	15403	15556	16361	17675	18969
Urban	10052	10293	10477	10693	11000	11500	12032	12970	14391	15733
Metropolitan	8219	8467	8586	8680	8976	9370	11304	11957	12908	14178
Population per office (in thousands)	15	15	16	16	16	16	16	15	15	14.5

* Excludes administrative offices.

Source : "Basic Statistical Returns of Scheduled Commercial Banks in India", Volume 38, March, 2009, Reserve Bank of India.

From Table 4, we find that the total number of bank offices in India has shown an increase of nearly 23 per cent from 2000 to 2009. However, the share of rural bank offices in the total bank offices in the country has come down from nearly 50 per cent in 2000 to nearly 39 per cent in 2009. On the other hand, the total number of bank offices operational in metropolitan and urban centres has increased by nearly 72 and 56 per cent, respectively during the same period.

Even though there has been rapid expansion of bank branches after the nationalisation of banks (1969) and post-liberalisation (after 1990), yet the number of persons served per branch is very high compared to other developed countries. Thus, there is a need to extend and expand the reach of banking services in India. Table 5 shows the number of individuals served per branch in different countries.

Table 5 : Number of Persons Served Per Bank Branch

Country	Number of persons per bank branch
India	16,129
United Kingdom	4,484
United States of America	2,720
Germany	1,945
Japan	3,968
Hong Kong	454
France	1,587
Canada	6,410
Sweden	4,672
Singapore	10,101

Source : Joint study by ASSOCHAM and research firm Ernst & Young; Website: http://www.zeenews.com/news506092.html accessed on 22/4/2011.

Rural Banking Opportunity

In recent times, rural India has presented significant business opportunity to different industries. Fast Moving Consumer Goods (FMCG) companies have expanded their businesses in rural India on a large scale. GoI has launched a number of schemes to increase rural employment. Prominent among them is the Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA) launched by the government in 2005. This scheme legally guarantees one hundred days of employment every year to every adult member residing in a rural area together with prescribed minimum wages. In the union budget, 2010-11, ₹ 40,000 crore has been allocated to MGNREGA scheme so as to bring about rural empowerment on a massive scale.

A report[4] by financial services firm, India Infoline, has indicated that there has been a growth of 135 per cent in the rural middle-class homes since 2001 and they represent 45 per cent of total national demand for consumer products. Such guaranteed employment schemes together with the rise in the middle-class population brings with it the demand for banking services and products since money in the form of wages is available in the hands of the rural people.

Post-liberalisation, all the major banks both in public and private sector have been competing heavily in the metropolitan cities and urban areas to attract and retain middle class retail customers. They had not given much attention to the rural segment due to the underdeveloped physical infrastructure. But in present times increased competition together with government's proactive development policies for rural areas has forced them to devise strategies and build business plans for rural customers. Rural India also has a large number of traders, entrepreneurs, small and medium scale industries, professionals, agriculturalists, horticulturalists and many others as potential customers.

Table 6 : Deposits and Credit of Scheduled Commercial Banks in Different Centres

(Percentage terms)

Centres	March 2000		March 2001		March 2002		March 2003		March 2004		March 2005		March 2006		March 2007		March 2008		March 2009	
	Deposits (%)	Credit (%)	Deposits (%)	Credit (%)	Deposits (%)	Credit (%)	Deposits (%)	Credit (%)	Deposits (%)	Credit (%)	Deposits (%)	Credit (%)	Deposits (%)	Credit (%)	Deposits (%)	Credit (%)	Deposits (%)	Credit (%)	Deposits (%)	Credit (%)
Rural	14.7	10.6	14.7	10.1	14.2	10.2	13.8	10.2	12.9	9.7	12.2	9.5	10.8	8.3	9.7	7.9	9.4	7.6	9.3	7.3
Semi-urban	19.7	12.2	19.6	11.5	19.1	11.2	18.9	11.3	17.7	11.4	16.9	11.3	14.5	10.0	13.8	9.7	13.3	9.6	13.5	9.3
Urban	23.0	17.2	22.9	17.4	22.8	16.5	22.8	16.4	21.9	17.1	21.5	16.4	20.6	16.4	20.5	16.3	20.4	16.1	21.0	16.1
Metro-politan	42.6	60.0	42.8	61.0	43.9	62.1	44.5	62.1	47.5	61.8	49.4	62.8	54.1	65.3	56.0	66.1	56.9	66.7	56.2	67.3
All India	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100

Source : Compiled from different volumes of "Basic Statistical Returns of Scheduled Commercial Banks in India", Reserve Bank of India.

Deposits and Credit

Depositing money in the bank and availing of credit in the form of loans form the basic banking transaction for retail customers in both rural and urban areas. Table 6 lists the percentage distribution of total deposits and credit of commercial banks among rural, semi-urban, urban and metropolitan centres.

From Table 6 it can be noted that the percentage of deposits is higher compared to the percentage of credit disbursed in rural centres. However, in metropolitan and urban centres, credit made available is more compared to the deposits secured. While the metropolitan centres are cornering more than 60 per cent of credit disbursed by scheduled commercial banks, the percentage of credit for rural centres declined from around 10 per cent (2000-2005) to around 7.5 per cent (2006-2009). It is an irony that 72 per cent of India's population live in villages but the credit disbursed in rural areas by the commercial banks is less than 10 per cent of the total credit available (for the period 2000 to 2009).

RBI's quarterly report [5] mentions that the Credit to Deposit (C-D) ratio was 59.0 per cent (rural centres), 51.8 per cent (semi-urban centres), 58.8 per cent (urban centres) and 84.9 per cent (metropolitan centres). Thus, the credit made available to metropolitan centres is more, compared to rural and semi-urban centres. Table 7 presents the distribution of bank credit to different sectors in percentage terms (Year 2000 to 2009).

Table 7 : Bank Credit to Different Sectors

(Percentage share)

Sector	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Agriculture	9.9	9.7	9.8	10.0	10.9	10.8	11.4	11.8	11.3	10.9
Industry	46.5	43.9	41.4	41.0	38.0	38.8	37.4	38.1	38.4	39.8
Transport operators	1.8	1.6	1.4	1.2	1.3	1.2	1.6	1.3	1.8	2.0
Professional services	3.2	3.6	4.2	4.5	5.0	4.8	5.4	6.2	7.7	8.7
Personal loans	11.2	12.2	12.6	15.1	20.3	22.2	23.3	22.3	20.1	19.5
Trade	15.6	16.6	15.4	13.8	11.5	11.2	9.9	10.5	8.8	9.8
Finance	4.7	4.9	5.7	6.7	6.7	6.4	6.3	6.4	7.l	6.6
Miscellaneous	7.1	7.5	9.5	7.7	6.3	4.6	4.7	3.4	4.8	2.7
Total	100	100	100	100	100	100	100	100	100	100

Source : As given in Table 6.

The economic survey (2009-2010) tells us that in 2008-09, the share of agriculture (including forestry and fisheries) in the GDP was 15.7 per cent and 52 per cent of the total workers are employed in agricultural sector (2001 population figures). But it is a matter of concern (as can be seen from Table 7) that bank credit to agricultural sector is hovering around just 10 to 11 per cent of the total credit made available by the commercial banks.

Banking Services

Information and Communication Technology (ICT) provides convenience for the banks to reach a large number of customers and offers them varied services in the shortest possible time. The website of a bank serves dual purpose for the customers. It not only provides all the information related to the products and services but also facilitates online transactions in real-time such as payment of different kinds of bills, transfer of money from one account to another, online shopping etc. Some of the new services that commercial banks have been offering to their customers through ICT are:

(i) Demat Service : Demat service is designed to facilitate storage as well as transfer of securities in a speedy and secure manner. Securities stored in physical form (as paper documents) may be lost or soiled. But under Demat service, they are stored in the electronic form for any length of time. A large number of commercial banks are offering the Demat service through their websites. Utilising this service, rural customers can operate the Demat account, trade in securities and gain from the capital markets, from the comfort of their homes, without having to travel long distances. Demat account holders can convert the securities from physical to electronic form and vice versa. Benefits such as bonus shares and rights issue can be credited directly into their Demat account. They can also hypothecate or pledge the securities stored in their account.

(ii) Real Time Gross Settlement (RTGS): This service is designed to facilitate inter-bank fund transfer. By utilising this service, customers can transfer funds from one bank account to another in real time without any hassles. In rural India, physical branches of banks are limited in number. Moreover, private and foreign banks are reluctant to open branches in rural areas due to overhead costs. In such a scenario, rural customers have to travel long distance to reach their bank's branch. RTGS helps them transfer funds by sitting in the comfort of their house. Convenient and comfortable banking experience would attract more customers to open accounts with the banks. However, reliable broadband connection is needed to effectively utilise this service.

(iii) Utility Bill Payment Service: Most of the public and private sector commercial banks offer the facility to pay utility bills (such as telephone bills, electricity bills, insurance premium, municipal taxes etc.) through Internet banking, phone banking and ATMs. Banks charge nominal amount to the customers while offering this service. Thus, it is a source of non-interest income. In addition, banks also accept ECS (Electronic Clearance System) mandate from their customers to pay utility bills. Under ECS, automatic payment of utility bill is effected on the due date by debiting the customer's account. ECS facility is free for the customers. Like RTGS, ECS facility particularly helps rural customers since they need not travel long distance and stand in queues to pay their bills. Also they need not worry about forgetting the due date of bill payment.

(iv)Internet Banking Service : A number of banks have been offering Internet banking service to their customers through their websites. Internet banking is convenient, hassle-free and can be used to carry out transactions in real-time. The main advantage is that almost all the banking related services can be offered through the bank's website in electronic form. Examples of these services include, transferring funds between different accounts, opening of fixed deposit, loan and savings bank accounts, placing a request for the issue of cheque book, demand draft etc., registering a complaint, payment of utility bills and credit card bill, online recharge of mobile phones, buying of movie tickets and many

more such services. According to Internet and Mobile Association of India (IAMAI), by 2010 there were only 5.4 million Internet users in rural India. This represents only 0.62 per cent[6] of the rural population of India.

For utilising Interent banking services, it is necessary to have dedicated Internet/ broadband connectivity. The Department of Telecommunications, GoI in its Annual Report (2010-11) has said that the GoI has introduced a prototype tablet Personal Computer (PC) (powered by solar power) for only ₹ 1500.00, in order to make the usage of computers financially feasible even to the poor people from rural areas. It has also provided subsidies for the establishment of wireless broadband infrastructure. The number of Common Service Centres (CSC) would also be increased from present number of 86521 to 100,000 in order to provide broadband coverage to all the villages in the country.

Internet banking service is advantageous for both banks and their rural customers. While banks can serve a large number of rural customers without incurring infrastructural costs, customers on the other hand can carry out most of their banking transactions without visiting physical branches. Moreover, they can carryout safe and secure transactions in electronic form, without the need to carry cash.

(v)Services Under Government Schemes: Commercial banks have been rendering their services to the society by facilitating the implementation of government schemes. Some of the schemes which deserve special attention are the New Pension System (NPS) and the MGNREGA. These schemes are designed to provide financial security and employment opportunities for the financially weaker sections.

NPS was introduced from 1 May, 2009 by the Pension Fund Regulatory and Development Authority (PFRDA) to offer old age pension to citizens in the age group of 18 to 60 years. A number of banks have been acting as Point-of-Presence (PoP), service providers and offering documentation services (through their branches) for the delivery of NPS. Subscribers can make contribution to the NPS either through bank branches or through ECS facility.

To check malpractices and avoid cash transactions, the Central government has decided that wage payments for people employed under MGNREGA should be done through the savings bank account. Banks can utilise the services of Business Correspondents (BCs) and biometric identification for encouraging workers to open their wage accounts and also for effecting payments in these accounts. The state governments will reimburse the transaction costs incurred by the banks by paying certain amount as fee (per account). Thus, for banks it will be another source of non-interest based income. According to the report of the Ministry of Rural Development, GoI, in the financial year 2009-10, 4.27 crore households were provided employment and 10.86 crore job cards were issued under MGNREGA. Since all the beneficiaries will be required to open savings bank account, banks can see a surge in their retail customer base.

(vi) Bancassurance Service: Bancassurance is the usage of banking channels to sell the insurance products (both life and non-life), based on the tie-up between banks and insurance companies. With the opening of insurance sector in 1999, there has been intense competition in the Indian insurance industry. Presently, in each of life and non-life insurance segments, there are 24 companies in operation. Commercial banks are not only selling insurance products but have also entered the insurance business by forging partnership with other banks and foreign insurance companies.

Annual survey (2010) conducted by FICCI (Federation of Indian Chamber of Commerce and Industry) has found out that Bancassurance is the most profitable opportunity for the banks in the non-interest income bearing category. Similar views are expressed by Indian Banks Association (IBA) in its report titled "Banking Industry Vision, 2010". The report also mentions that rural markets account for 74 per cent of population, 41 per cent of middle class and 58 per cent of disposable income. In India, only 22[7] per cent of the insurance sales are through Bancassurance. Thus, there is a vast market to be explored under Bancassurance.

The Economic Survey (2010-11) has revealed that the growth of life insurance premium has been nearly 26 per cent and insurance penetration has been 5.4 per cent of the GDP in 2009. According to a research paper on insurance industry brought out jointly by CRISIL (Credit Rating Information Services India Limited) and ASSOCHAM (Associated Chambers of Commerce and Industry of India), the penetration of general insurance business is only 0.6 per cent of the GDP while the world average is 2.14 per cent. The reasons cited being the untapped rural markets, low preference and limited distribution channels. The penetration[8] of insurance business in urban India is at 47 per cent while it is only 27 per cent in rural India.

Bancassurance would turn out to be a 'Win-Win' situation for both the banks and the insurance companies. In India, public sector banks have a huge network of brick and mortar branches, spread across the country. A large number of customers visit the bank's branches and many of them would be in need of insurance products. Bank employees should be properly trained and given incentives for selling these products. IRDA is of the opinion that selling insurance products through agency model has lost its sheen in many parts of the world including India. In its opinion Bancassurance can turn out to be an efficient channel for selling insurance products. It has also allowed banks to sell policies of more than one insurance company.

Financial Inclusion

Banks being commercial entities, offer their services by weighing the transaction costs against the profits. Therefore, they prescribe certain minimum amount of deposit for opening and maintaining an account. For people with education and employment in organised sector, it is very easy to open a bank account and avail of related services. Besides, employees working in the corporate sector are provided corporate salary accounts by their respective organisations. But for the majority of rural masses, neither there are sufficient branches in their vicinity nor can they satisfy banking norms for opening an account. Thus, they remain excluded from the formal banking system.

For RBI, financial inclusion forms a major objective under priority sector lending. In order to bring marginalised sections within the formal banking ambit, RBI has advised banks to make provision for basic banking 'No frills' account. Such accounts are meant for those low-income individuals who earn very meagre salary/wage income, just enough for their survival. It is permitted to maintain either zero or very low minimum balance in the 'No frills' accounts. Annual policy statement (2005-06) of RBI suggests banks to change/modify their existing practices so that the objective of financial inclusion is fulfilled conclusively. RBI has simplified KYC (Know Your Customer) banking norms for low-income customers and has brought small balance accounts under low-risk category. Along with public sector banks, some foreign and private banks have also started offering 'No frills' accounts. RBI's annual report (2009-10) mentions that the total number of 'No frills' accounts is 5.06 crore between November, 2005(when such accounts were permitted) and March, 2010. The total amount outstanding in such accounts is ₹ 5,386 crore.

Prof. Suresh D. Tendulkar Committee report (accepted by the Planning Commission) constituted for the estimation of poverty mentions that 37.2 per cent (i.e. nearly 37 crore people as per 2001 population census) of the total population come under the category of Below Poverty Line (BPL). Thus, BPL population is about seven times the existing number of 'No frills' accounts if we assume that there exists only one 'No frills' account per individual.Thus, there is still a long distance to be covered in order to achieve the goal of total financial inclusion.

Some banks have also started offering overdraft facility to such account holders.The amount of overdraft stands at ₹ 28 crore by March, 2010. With the intention of making 'No frills' accounts financially viable, government has constructed a fund of ₹ 800 crore.This fund will reimburse the costs incurred (such as paying commission to business correspondents, setting up of branches in rural areas etc.) by the banks in rural and unbanked areas.

Through 'No frills' accounts, poor people can also be offered other banking products such as fixed deposits, insurance products, recurring deposits, loan products, credit cards, overdraft and money transfer facility. This will widen the scope of financial inclusion. In retail banking segment, it is the number of accounts rather than size of an account that brings profit to the banks. For banks, credit risk is minimum in 'No frills' accounts because the exposure is very limited.

Information Technology (IT) can prove critical for banks in not only identifying rural customers but also reducing the transaction costs associated with 'No frills' accounts. In this regard, the Unique Identification (UID) project launched by Unique Identification Authority of India (UIDAI)[9] would come handy for both banks and its customers. Under UID project, every Indian will be issued a unique twelve-digit number, linked to his/her biometric features. A UID number will be sufficient for rural and illiterate customers for opening an account in the bank without the need for additional documents.

Rural Banking Models

For banks, opening a brick-and-mortar type branch in rural area may not be financially and operationally viable because of many constraints such as logistics, administration, physical infrastructure and employee well-being. Therefore, they need to scout for innovative models. In these models electronics and IT components would have a prominent role in reducing costs and increasing the number of rural customers. Outlook Business[10] magazine reports that for a bank, a single transaction carried out through a Teller costs ₹ 50 to ₹ 150. On the other hand, a transaction carried out through an Automatic Teller Machine (ATM) costs ₹10 to ₹18 while that carried out through mobile banking costs less than ₹ 5. However, local individuals and institutions at grassroots level should be involved in a prominent way in order to make these models operational in a successful manner.

A Automatic Teller Machines (ATMs)

An ATM is an electronic machine based on Information and Communication Technology (ICT), using which customers can access account information and also withdraw cash. In addition, customers can also obtain savings/loan account information, deposit the cash and pay utility bills. Banks can install ATMs at convenient locations in a small place and they have proven to be cost-effective, compared to a full-fledged branch. Rural customers can use locally installed ATMs, instead of travelling long distance to cities and towns. Average population per branch and per ATM provides an indication towards the extent of penetration of banking services as can be seen from Table 8.

Table 8 : ATMs and Population Per Bank Branch in Different Centres

(March, 2010)

ATMs and Population per bank branch	Rural Centres	Semi-urban Centres	Urban Centres	Metropolitan Centres	Total
Number of ATMs	5,196	14,478	19,763	20,716	60,153
Percentage share of ATMs	8.6%	24.1%	32.9 %	34.4%	100%
Population per ATM*	43,500	8,100	19,700		
Number of ATMs per 1,00,000 population	——	——-	5.07		
Population per bank branch*	16,100	10,400	14,000		
Number of bank branches per 1,00,000 population	——	——-	7.13		

* Population of rural and semi-urban centres is taken together. Also population of urban and metropolitan centres is taken together.

Source : Report on Trend and Progress of Banking in India 2009-10, Reserve Bank of India.

The number of branches and ATMs per 1,00,000 population according to the benchmark set by the OECD (Organisation for Economic Cooperation and Development) countries is (23-45) and (57-158), respectively. But from Table 8, we find that in India this figure is only 7.13 and 5.07, respectively. Thus, considering the OECD benchmark, India scores very poorly. From Table 8 it can be seen that the population per ATM in rural and semi-urban centres are nearly five times that of urban and metropolitan centres. Also the population per bank branch is higher in rural and semi-urban centres compared to urban and metropolitan centres. From this we can infer that there is a need to increase the number of ATMs and bank branches in rural and semi-urban centres.

B Business Correspondents

RBI has permitted banks to avail of the services of companies having retail outlets, retired government employees, teachers, grocery shop owners, insurance agents, SHGs and post offices in the capacity of Business Correspondents (BCs). BCs deliver retail banking services such as opening of a bank account or fixed deposit, collecting interest on loans, selling insurance and mutual fund products, issuing receipts etc., on behalf of banks to the rural customers. The services are delivered through Internet kiosks or hand-held communication devices linked in real-time to the bank's core banking network. However, a bank is ultimately liable for any acts of omission or commission of BCs, appointed by it. RBI has made it mandatory that every BC has to work for only one particular bank and should not collect any fees from the customers. With the expansion of banking services in rural areas, the services of BCs would become paramount. This would create huge employment opportunity for rural masses.

Rural internet banking model of SBI is implemented through the BC model. In this model, Internet kiosk owners acting as BCs, help villagers perform basic banking operations. Biometric parameters are used to authenticate Internet banking operations. Internet kiosks, acting as mini-bank branches are connected to the LAN (Local Area Network) server of SBI.

A Working Group constituted under the chairmanship of Mr. P.Vijaya Bhaskar, reviewed the BC model and submitted a report to RBI in August, 2009. The important findings of this Working Group are:

(i) Out of a total 50 public sector and private sector banks, only 26 have appointed BCs.

(ii) Public sector banks have appointed a total of 85 BCs and the number of accounts opened through them is 80,47,007.

(iii) Private sector banks have appointed a total of 44 BCs and the number of accounts opened through them is 8,13,259.

(iv) The total number of no frills accounts opened through BCs is 88,60,266 which constitute only 26.82 per cent of the total number of frills accounts opened as on 31March, 2009.

(v) A majority of the no-frills accounts opened through BCs have remained non-operational.

(vi) The commission paid by banks to the BCs is not adequate to cover their costs related to transportation, operations, insurance and security. Therefore, majority of BCs have withdrawn their operations.

(vii) In the BC model, banks face different types of risks such as credit risk, operational risk, legal risk, liquidity risk and risk of reputation. They have to take adequate measures to reduce these risks.

C Mobile Banking

Mobile banking is the provision of banking service, made available through the telecommunications network and accessed through a mobile phone. Mobile phones are available at a fraction of cost and thus affordable to poor people from rural areas. According to Telecom Regulatory Authority of India (TRAI), there are about 77 crore[11] wireless telephone subscribers in India as on January, 2011. Out of these, nearly 26 crore are rural subscribers. Thus, nearly 63.34 per cent of the total population (121 crore, as per 2011 population census) and out of which nearly 34 per cent of rural population have access to mobile phones. The rural wireless teledensity has increased from 30.11 to 31.05 (between December, 2010 and January, 2011). Also subscription to wireless telephone services in rural areas has increased by 3.20 per cent compared to an increase of 2.19 per cent recorded in urban areas during the same period. This shows that mobile banking model can be effectively used by the banks to offer their services even in the remote areas.

Three types of banking services are made available through a mobile phone– Information-based, Transactions-based and Relationship-based. Information-based services include supply of essential information related to savings/loan account, credit/debit card etc. through customer care centres.Transaction-based services is the next higher level service which facilitates transactions such as transfer of funds from one account to another, stock trading and opening/ closing a loan account. Relationship-based service includes building personalised relationships between the bank and its customers such as targeted promotions and alert messages through SMS (Short Message Service). All these services are available 24X7 basis by clicking a few buttons on the keypad of the mobile phone. Mobile phones permit ‘Anywhere, Anytime Banking’ since they can be carried in pockets or in handbags. Web-enabled services provided through mobile phones facilitate internet banking transactions by browsing the bank’s website in real-time.

In Banknet’s Payment Conference[12] it was revealed that government has permitted 32 banks to offer mobile banking services in the country and 21 banks have been offering these services. RBI has allowed funds transfer to a maximum of ₹ 50000 per customer per day through mobile banking. However, there is no limit on the amount of funds that can be received.

D SHG-Bank Linkage Programme

NABARD was the pioneer to start the SHG-Bank linkage programme in the country in 1992. A SHG can be formed by 15-20 rural poor people belonging to economically homogeneous and affinity group. Each member contributes a small amount as savings to the group fund in order to start small businesses either individually or as a group. Thus, individuals who do not have access to formal banking system form a SHG. Members of SHG can open a savings bank account and also avail of credit facility from the bank on the strength of their collective savings. Banks provide credit facility to SHGs either directly or through Non-Governmental Organisations (NGOs) and Micro-Finance Institutions (MFIs). Members of SHGs are collectively responsible for the disbursal of credit amongst themselves and also for the repayment of loans.

SHG-Bank linkage programme has achieved tremendous success in promoting financial inclusion in India. According to NABARD’s status report on Micro-finance (2009-10), the number of SHGs having savings and credit linkage with banks are 69.53 lakh and 15.87 lakh, respectively, bringing about 9.7 crore poor households under their ambit. The savings of SHGs with banks as on March, 2010 amounted to ₹ 6198.71 crore registering a growth of 11.80 per cent over the previous year. Bank loans disbursed to SHGs during 2009-10 was ₹14453.30 crore registering a growth of 17.9 per cent over the previous year. This shows that the growth of SHGs would not only help banks penetrate rural areas but also help them augment their revenues.

Factors for the Success of Rural Banking

Banks should be given freedom to raise or lower the interest rates (within certain limits) in different geographical regions according to the profile of their clients. Differential interest rates would help banks pay adequate commission to the BCs and ensure the feasibility of their operations. Banks should train their field staff adequately and grant them operational autonomy so that they provide better services to rural customers.

ATMs installed in rural areas should withstand voltage fluctuations and high temperatures. Preferably ATMs in rural areas should make use of customer’s biometric parameters rather than the password or PIN (Personal Identification Number). This is because passwords can be easily lost, hacked or shared unknowingly. Biometric identification is unique, tamper proof, accurate and authentic. It also does not require customers to be literate.

Information related to the borrowers and their businesses in a particular geography are paramount for banks, intending to operate in rural areas. Hence, NABARD has proposed establishment of rural credit bureaus as a joint venture in association with ICICI bank and Credit Information Bureau of India Limited (CIBIL). Rural credit bureaus will help banks, share and utilise information related to fraud and loan default, pertaining to rural customers. It will also help borrowers with good track record avail of loans in the shortest possible time. Banks can implement risk management processes effectively in compliance with Basel II norms using timely information available through the credit bureau. In future, the scope of rural credit bureau would expand when more banks intending to start operations in rural segments, become part of it.

There are around 1,55,015 post offices[13] in India at the end of the financial year (2009-10) making it the largest network in the world. Of these 1,39,144 post offices (i.e. 89.76 per cent) are located in rural areas. The postal department has rich experience in offering financial products such as savings account and term deposits of small amounts. Banks can partner with post offices in locating potential rural customers and market different products and services jointly. Only minimal investment would be needed to improve the infrastructure, already available with the post offices. This synergy between the banks and post offices will reduce operational and infrastructure costs.

Financial literacy and financial inclusion go hand-in-hand. Awareness about financial matters and services will lead to more people accessing institutional sources for their credit needs. RBI has started a project named "Project Financial Literacy" for educating women, school and college going students, poor people from urban and rural areas and others about various banking concepts. In addition, it has asked lead bank in each district to prepare a blue-print so that all villages with population of above 2000 have access to some banking outlet by March, 2012.

Conclusion and Suggestions

Commercial banks should realise that rural India also offers vast business opportunity. To tap it they need to undertake proper research and select suitable business model and technology that is operationally and financially feasible. Since India is highly diversified in terms of culture, language, tradition and social groups, involvement of local persons in banking operations would permit rendering of banking service without any hassles. The crucial thing for banks in rural areas is to simplify the documentation process and create awareness about different financial services on a large scale. This will eliminate the involvement of touts, agents or middlemen in the transactions between banks and their customers. Segmenting the rural market based on the income or occupation and offering them banking and insurance products would go a long way in attracting rural customers.

Based on the economic survey (2010-2011), about 42 per cent of savings in rural India are held in the form of cash. Through tailor-made financial inclusion schemes, the cash available in the hands of rural masses can be diverted to savings bank accounts. This cash when brought into mainstream economy can turn out to be a major source of investment for rural development and infrastructure projects which suffer from chronic financial crunch and escalating costs. These projects would generate huge employment opportunity which in turn increases the demand for banking services. Additionally, the domestic savings rate can also be increased thereby minimising the dependence on global financial markets and institutions which are highly volatile in present situation of global financial crisis.

Along with appropriate products and services, it is necessary to modify them according to changing needs. Customer care centres should be established in large numbers for handling customer queries, grievances and for dissemination of information in local languages. Rural farmers do not mind paying higher interest rate on agricultural loans. But they should be made available at the appropriate time. Hence, government and RBI should take steps to reduce red tapism and politically motivated sops and subsidies. Government should encourage private participation in the development of infrastructure facilities in rural areas. In a nutshell, the field is wide open for commercial banks to venture into the rural banking arena. They can tap this opportunity through strategic thinking, planning and perseverance.

References

1. Annual Reports of Reserve Bank of India.
2. Annual Report (2010-11), of Department of Telecommunications, Ministry Of Communications & IT, Government of India.
3. NABARD (2010), "Status of Micro Finance in India 2009-10", National Bank for Agriculture and Rural Development (NABARD)
4. NABARD (2009), "Status of Micro Finance in India 2008-09", National Bank for Agriculture and Rural Development (NABARD)
5. NSSO (2006), "All-India Debt and Investment Survey NSS 59th Round (January–December 2003)", National Sample Survey Organisation, Ministry of Statistics & Programme Implementation, Government of India.
6. Planning Commission (2009), "Report of the Expert Group to Review the Methodology for Estimation of Poverty", Government of India.
7. RBI (2008), "Report on Currency and Finance : 2006-08", Reserve Bank of India, Mumbai.
8. RBI (2009), "Report of the Working Group to Review the Business Correspondent Model", Reserve Bank of India, Mumbai.
9. RBI (2009), "Basic Statistical Returns of Scheduled Commercial Banks in India", Volume 38, March, 2009, Reserve Bank of India, Mumbai
10. RBI (2010), "Handbook of Statistics on Indian Economy", Reserve Bank of India, Mumbai.
11. RBI (2007), "Report of the Technical Group to Review Legislations on Money Lending", Reserve Bank of India, Mumbai.
12. RBI (2010), "Report on Trend and Progress of Banking in India 2009-10", Reserve Bank of India, Mumbai.
13. Union Budget (2010-2011) and Economic Survey (2009-10)
14. Union Budget (2011-2012) and Economic Survey (2010-11).

Notes

[1] Government of India, Ministry of Home Affairs, Office of the Registrar General & Census Commissioner, Website: www.censusindia.gov.in, accessed on 25/4/2011.

[2] According to RBI, unbanked centre is one wherein there is no functioning branch of any commercial/ cooperative bank.

[3] Remarks by Dr. Duvvuri Subbarao, Governor, Reserve Bank of India at the Bankers' Club in Kolkata on 9/ 12/2009.

[4] Report "Kisan Is King" by financial services firm, India Infoline. Website: http://www.moneycontrol.com/ news_html_files/news_attachment/2008/tfp200812161.pdf accessed on 27/4/2011.

[5] RBI's Quarterly Report, "Quarterly Statistics on Deposits and Credit of Scheduled Commercial Banks", March 2010.

[6] Population of India according to 2011 census is 121 crore and rural population is about 87 crore (72 per cent of total population).

[7] 7th Asian conference on Bancassurance & Alternative Distribution Channels, 2006 Mumbai.

[8] www.business-standard.com/india/ accessed on 30/8/2011.

[9] The Unique Identification Authority of India (UIDAI) constituted under the guidance of Planning Commission of India in 2009 with Shri Nandan M. Nilekani as its chairman.

[10] Anurag Prasad, "Swipe that Phone", Outlook Business magazine. Website : http://business. outlookindia.com/print.aspx?articleid=1403&editionid=39&catgid=29&subcatgid=705 accessed on 25/4/2011.

[11] Telecom Regulatory Authority of India (TRAI), Press release No. 13/2011, Date, 4/3/2011. Website: http:/ /www.trai.gov.in/WriteReadData/trai/upload/PressReleases/800/PressRelease04Jan2011.pdf accessed on 25/4/2011.

[12] Banknet's Sixth Annual Conference on Payment Systems, 22/1/2010, Mumbai.

[13] Annual Report (2009-10), Department of P osts, Government of India.