

India's Financial Sector: Chanting the rural mantra



Rural - the word has become synonymous with growth in the emerging economies. More so in India, where over 65% of the population even today resides in villages. Hence, it has become imperative to align the nation's business agenda along with the needs of this segment. Concurrently, the government's thrust to the development of the rural sector is creating a more favorable landscape for business in the country's hinterland.

Fast Moving Consumer Goods companies led by ITC and HLL, were the first to make a fortune in rural markets. Several major developments have taken place since then in this sector, leading to all types of businesses chanting the rural name as their success mantra. The potential is undeniable; rural India is finally venturing into light after years of abandonment.

A market waiting to happen

Although 70% of India's villagers do not have bank accounts, financial products are not unknown to them; albeit the sources of supply are mainly informal - savings are mostly in the form of gold, whereas loans come from bloodsucking village moneylenders. Taking a leaf out of the FMCG book,

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Yearly demand for credit estimated at Rs.150,000 crores

RBI is considering allowing banks to work with village money lenders to reach the rural population

the Indian financial sector has started taking a serious look at low income segments in under-banked markets. The Government of India too, has shown some support in this regard. The Union Budget 2006-07 proposed a number of schemes for rural India, including creation of employment opportunities and a National Rural Health Mission. The government has also instructed banks to extend farm loans at a favorable rate of 7% to bring more farmers under the organized credit net, and take the overall farm credit to Rs. 1, 75,000 crore in 2006-07 (an increase of about Rs. 33,500 crore). According to Dr. Nachiket Mor¹, Deputy Managing Director, ICICI Bank, "The informal credit segment is about US\$ 82 billion. Yearly demand for credit is estimated at about Rs 1, 50,000 crore, of which Rs 4,000 crore is actually met." In addition, banks are being asked to bring 50 lakh more farmers into the banking fold.

To tap this potential, the RBI is considering other innovative measures like allowing banks to use village moneylenders to reach the rural populace. Moneylenders are said to control a third of all rural loans, and wield considerable strength, given their personal acquaintance with the local population and ubiquitous distribution network. Banks hope to leverage their low cost funds to lend to moneylenders, who can in turn give loans to the rural folk at far lower rates than the usual monstrous

60-70%! This is also a ploy to bring the moneylenders under the regulatory purview. That being said, it will be no less than a Herculean task to break the moneylenders' stranglehold!

(Rural) Way to go!

Getting the poor to bank and bank profitably is the new motto! India's largest bank, State Bank of India (SBI), has a breathtaking rural branch network of 6,600 with 972 specialized branches. These branches have been set up in different parts of the country with the sole purpose of developing agriculture through credit deployment. In addition, SBI has also developed rural agricultural business units, education programmes for local farmers and "kisan" cards. State Bank of India has gradually evolved to become the leader in agricultural finance with a portfolio of Rs. 18,000 crore in loans to around 50 lakh farmers. One of their recent endeavors is the tie-up with National Agricultural Cooperative Marketing Federation (NAFED) to finance farmers for cultivation of various crops like soyabean, paddy, jute and potato.

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Private sector banks too, have geared up for a piece of the cake. ICICI Bank, the country's second largest bank, has adopted the franchise model of operation in rural markets. Unconventional indeed! A one man office (known as "kendra") in the village forms an interface between the villager and the

ICICI Bank adopts the franchisee model for rural operations

Bank's products and facilities. Crop loans, housing loans, automobile loans, farm equipment, seed financing and insurance policies are all on offer.



"This is a scaleable model", says K.V.Kamath², MD & CEO of ICICI Bank. The number of borrowers has risen from 130 in 2000 to over 42,000 today, and the rural loan book has crossed Rs. 16,000 crore. What's more, the bank's default rate in the rural retail sector is 1 - 2 % as compared to 2 - 3% in the rural wholesale sector and 5% for the banking sector as a whole.

Other banks like Canara have launched aggressive grass-root level plans, in a bid to achieve 100% financial inclusion in 1,400 villages all over India, which could bring 7 lakh families into their net. Under this programme, every adult member of a rural household in the selected villages would be encouraged to open a 'No Frills' account with minimum entry-level formalities.

Foreign banks look
villageward

Having spread their tentacles in urban markets, foreign Banks like Citibank, HSBC and Standard Chartered are now looking "villageward". Citi is reported to be in the hunt for several rural branch licenses. There is a new focus on the SME segment as well.

Other financial products making their way into villages include IFFCO-Tokio's weather insurance product, 'Barish Bima Yojana' for farmers in Rajasthan and ICICI Lombard's medical insurance scheme 'Sanjeevini' for farmers in Punjab besides commodity futures and weather derivatives.

An important shift is underway in banking credit portfolios, which are no longer merely crop loans, but are increasingly used for financing investment. This is a sign of the beginning of maturity in these markets. However, we are still at the tip of the iceberg, and it will take a lot more effort in terms of product innovation, distribution development and awareness generation, before the needs of the rural market are adequately served.

Whither the Regional Rural Bank?

Ironically, as their urban counterparts are marshalling their efforts to penetrate the rural market, the Regional Rural Banks (RRBs) are bowing out. RRBs (also known as 'Gramin Banks') were set up with the objective of catering to the rural segment. However, they were undone by shortsighted government policy, which failed to take cognizance of their specific needs. Financial liberalization has placed both RRBs and other commercial banks on the same platform. Similar treatment, in terms of regulations, capital adequacy norms, and other compliance requirements, has

Shortsighted Govt policy fails to look at the specific needs of regional rural banks

been meted out, overlooking the fact that rural banks face hurdles in terms of higher transaction costs and difficult credit deployment and loan recovery. Recently, the government has initiated moves to merge these banks with their sponsor banks; as a result their numbers have quickly dwindled. The roadmap for India's banking sector envisions the emergence of a clutch of mega banks, each the size of SBI, formed by the merger of existing banks, to be in place by 2009 when the doors will be thrown open to foreign competition. The absorption of RRBs can be viewed as the prelude to the main act.

An imperative for the future

To echo the thoughts of C.K. Prahlad, the "bottom of the pyramid" segments will be the growth drivers of the future - this is certainly being borne out by the market revolution that is taking place in India's villages. Side by side, the Indian financial services industry is in a stage of transition, as it prepares for the inevitable onslaught of competition, once the barriers are dismantled in a few years. Therefore, it is critical that efforts are made to expand the overall market. Developing the rural financial market not only achieves this purpose, it will also give existing players a competitive edge in distribution which will be hard to beat.

"Bottom of the pyramid" segments will be the future growth drivers

Resources:

- *(1) India Brand Equity Foundation*
- *(2) Business Today - ICICI Bank's Rural Thrust, 4th June 2006*
- *Frontline - Saving The Regional Rural Banks, Volume 23 - Issue 03, Jan. 28 - Feb. 10, 2006*
- *IGIDR - New Products, Processes And Technology For Rural Access To Finance In India*
- *Reserve Bank of India - Population Group-wise Distribution of Number of Offices, Aggregate Deposits and Gross Bank Credit, All Scheduled Commercial Banks, Reserve Bank of India.(2001 - 2006)*
- *The Economic Times - News articles*



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