

STRUCTURAL REFORMS IN ARDBS : ISSUES AND PROSPECTS *

Mr. Chairman, Ladies & Gentlemen,

I am very happy to participate in this workshop and to deliver the inaugural address. I thank the organizers for this opportunity.

Various measures of financial sector reform were initiated in India since 1991 and it is amply clear that these measures have now started producing durable results. In particular, these measures enabled the banking sector to face a number of challenges boldly. The prudential and supervision norms which we are following today are internationally comparable and Indian banks are reasonably sound. The very fact that Indian banks are not affected by the contagion due to South East Asian crisis is a clear testimony to this. With a view to proceed further, it is important that cooperative banks are also placed on sound footing. Having said this, it is most appropriate to evaluate the progress of structural reforms in Agriculture and Rural Development Banks in India and to plan the future course of action with a view to place them on sustainable growth. In this context, the conduct of this workshop is very timely and I congratulate the organisers.

The importance of agriculture sector in the Indian economy can hardly be over-emphasised. The cooperative banks play an important role in the rural credit delivery system. They account for about 30% of total rural deposits and a little over 44% of loans and advances outstanding for agriculture and rural development in the country. The rural credit system needs to meet the growing requirements of agriculture which is becoming input-intensive and getting diversified. The demands on the system are enormous. At the same time, the requirements of the poorer sections to create productive assets have to be met. Obviously, the strategy and approach of the credit delivery system to meet the needs of the various segments have to be different even when the same institution is required to cater to all the segments.

The role of credit and credit institutions in augmenting production and productivity is well recognized. The main thrust of Indian public policy towards rural credit has, therefore, been to ensure that sufficient and timely credit, at reasonable rates of interest, is made available to as large a segment of the rural population as possible. The strategies followed have undoubtedly helped to build up a broad-based institutional infrastructure for the delivery and deployment of credit.

The financial sector reform that is currently underway encompasses the institutional rural credit delivery system as well. The essence of these measures is to improve the efficiency and productivity of all credit institutions including rural credit institutions, where a good number of cases do not enjoy satisfactory financial health. Institutional development is an evolutionary process. Continual self-assessment and adaptation are crucial. The progress of the rural financial institutions (RFIs) will have to reflect the trends towards greater efficiency and effectiveness. The specific measures needed to improve the organisational effectiveness will vary from one type of institution to another.

Evolution :

Let me briefly mention the evolution of Agriculture and Rural Development Banks (ARDBs). The evolution of Land Development Banking in India can be put into three distinct phases. The first phase is the Land Mortgage Banks (LMBs), which were established and mainly confined to provision of long-term credit to farmers for redemption of debts or acquisition of ownership rights on lands against mortgage of land based securities which continued upto mid 1950s. The

second phase virtually started after the findings and recommendations of the All India Rural Credit Survey Committee (1954), recommending the need for a separate Long-term Cooperative Credit Structure and also the establishment of Land Mortgage Banks in all States. The Committee suggested that the LMBs segment of the cooperative credit system should be restructured to broad-base its activities to provide finance to the farmers for acquisition of assets needed for improving the agricultural productivity. Accordingly, steps were taken by the erstwhile Agricultural Credit Department (ACD) of RBI in consultation with the Government of India for implementing these recommendations and allowing Land Mortgage Banks (LMBs) to undertake financing for investments in productive purposes related agricultural activities like sinking of wells, purchase of pumpsets and other agricultural implements and equipments. After the recommendation of the All India Rural Credit Review Committee, there was a distinct shift in the disbursement of credit from the conventional function, viz., debt redemption and ownership rights towards granting of loans for meeting credit requirements of agriculturists for investment purposes. It is in this context, the RBI had also set up in 1963 a separate body, i.e., Agricultural Refinance Corporation (ARC) for supplementing resources of the banks. Initially, it was extending refinance support to the Land Mortgage Banks for meeting financial requirements of the Central Land Mortgage Banks (CLMBs). Later on, the role of LMBs was further amplified to cover various non-land based activities allied to agriculture like, dairy, poultry, fishery, piggery, sericulture, etc. Thus, the advances for productive purposes, which were as good as 'Nil' in 1950-51, had risen enormously in 1970-71. It is, at this time, with the emphasis on developmental lending, the LMBs had acquired the nomenclature of Land Development Banks (LDBs). With a view to enlarge the function of ARC, RBI had constituted in 1975, Agricultural Refinance and Development Corporation (ARDC). The aim was to provide not only the required financial assistance to the Land Development Banks (LDBs), but also other needed support for upgrading the quality of their loans. The present phase can be construed as the third phase in which the Land Development Banks' (LDBs') operations cover virtually all rural economic activities including those in the non-Farm sector like cottage & village industries, handicraft, village artisan, etc., with the formation of National Bank for Agriculture and Rural Development (NABARD) in 1982. With the shift in the overall functions and coverage of LMBs and later LDBs, to the role of encompassing virtually all rural economic activities, the LDBs came to be known as Agricultural and Rural Development Banks.

Organisational Structure :

Organisational structure of long-term cooperative credit institutions differs from state to state. There are at present mainly three structures apart from one State, i.e. Andhra Pradesh, where the structure is integrated. Eight States, viz., Bihar, Gujarat, Jammu & Kashmir, Maharashtra, Manipur, Pondicherry, Tripura and Uttar Pradesh, are operating with unitary structure where the operations are carried out by the apex SCARDB through its branches.

Another 8 States, viz., Haryana, Karnataka, Kerala, Madhya Pradesh, Orissa, Punjab, Rajasthan and Tamil Nadu, are operating with federal structure in which the SCARDBs operate at the apex level and the PCARDBs operate as independent units at the base level affiliated to the SCARDBs of the State concerned.

Three states, viz. Assam, Himachal Pradesh and West Bengal, are operating with mixed structure in which at the apex level the SCARDB operates through its branches. There are also PCARDBs operating at the base level affiliated to the same apex bank at state level.

In the state of Andhra Pradesh, the short-term and long-term cooperative structure have been integrated for the last 5/6 years. Similarly in smaller states like Arunachal Pradesh, Meghalaya,

Mizoram, Nagaland, Goa, Delhi and Union Territories like Chandigarh and Andaman & Nicobar, the two tier SCBs are catering to the long term credit needs of farmers.

Credit Disbursements :

The SCARDBs have been playing a significant role in extending credit for capital formation in agriculture and rural development. The ground level disbursement by SCARDBs have been growing substantially from Rs.400 crore in 1983-84 to around Rs.10443 crore by March 1999. The role of SCARDBs in credit dispensation in the years to come is likely to further expand with diversification of various investment activities in farm and non-farm, rural housing sector, etc. The flow of credit at ground level for investment activities through floatation of Special Development and Ordinary Debentures has been increasing steadily.

The NABARD refinance to SCARDBs in the last 16 years has increased from Rs.1633 crore in 1982-83 to Rs.2168 crore in 1998-99 and the cumulative disbursement of refinance to SCARDBs stood at Rs.16470 crore as on 31st March 1999. Thus, the finance support to SCARDBs towards schematic lending revealed a compound growth rate of 15 per cent for the years between 1982-83 to 1998-99. There had been a steady rise in the floatation of Special Development Debentures (SDDs) from Rs.1,222 crore in 1993-94 to Rs.2,429 crore in 1997-98. As regards the floatation of Ordinary Debentures, the same was at Rs.86.48 crore during 1993-94, which had declined to Rs.83 crore during 1995-96 with marginal increase in the subsequent year (1996-97), which has reached a level of Rs.99 crore during 1997-98. The major chunk of refinance from NABARD during 1998-99 is for farm mechanisation (31%) and minor irrigation (18%), dairy development (15%) and non-farm sector (14%).

As per the data available in the LT structure, 10 SCARDBs (constituting 53% of the total SCARDBs) and 433 PCARDBs (45% of the total PCARDBs) incurred loss in 1997-98, amounting to Rs.153 crore and Rs.186 crore respectively as against 8 SCARDBs (Rs.57 crore) and 383 PCARDBs (Rs.51 crore) during 1996-97. The accumulated losses range from Rs.0.14 crore in Pondicherry to Rs.286 crore in Maharashtra and in case of PCARDBs, this ranges from 0.41 crore in Punjab to Rs.183 crore in Karnataka.

Issues :

Even though the success stories of co-operatives vary from state to state, they, nevertheless, provide hope for the future. Although a structure exists, we should create an environment in which it can function efficiently. We should be bold enough to identify where things have gone wrong and we should be willing to adopt measures that are necessary to correct them. In this context, issues such as a better appraisal of applications for lending, stress on mobilisation of rural savings, greater autonomy on the decision-making process, restoration of the democratic process, freedom from bureaucratic controls and financial and operational diversification should be the elements of any future programme of action.

Let me elaborate them.

(a) Regarding resources, SCARDBs depend on borrowings from NABARD and with a view to strengthen their resource base, they were permitted to mobilise fixed deposits for period not less than 12 months subject to aggregate deposits outstanding not exceeding net owned funds of the bank in the previous year's balance sheet. Further, PCARDBs have been allowed to mobilise deposits only as agents of SCARDBs. It is important to recognise that any further relaxation is to be viewed from supervisory and regulatory angle. The recent RBI Discussion Paper entitled, "Harmonisation of role and functions of Development Financial Institutions and banks"

adequately addressed this issue. The ARDBs are akin to DFIs which mainly cater to the long term funds requirements. It is our endeavour to maintain a level playing field for institutions performing similar functions.

(b) One of the important reasons for the recent turmoil in South East Asia was the absence of proper disclosures in the balance sheets of financial intermediaries. The transparency of the banking and financial system is an issue related to sound financial infrastructure. In fact, the lack of transparency results in incentive to 'evergreen' loans, thereby impacting on the performance of assets.

A major element of the financial sector reforms in India has been the application of prudential norms and regulations introduced in 1992 aimed at ensuring safety and soundness of the financial system and at the same time encouraging markets to play increasing role. Prudential norms serve two primary purposes – first they reveal the true position of the bank's loan portfolio and secondly, they help arrest its deterioration. Prudential reforms introduced in India relate to income recognition, asset classification and provisioning for bad and doubtful debts and capital adequacy.

Prudential norms were introduced during the year 1997-98 in SCARDBs/PCARDBs with the objective of making full provisions. As ARDBs (both Primary and State levels) have expressed difficulties in following the norms, they have been advised to make 100 per cent provision for loss assets and not less than 30 per cent in case of sub-standard and doubtful assets during 1997-98 and full provisioning from 1998-99 onwards. I am happy to note that SCARDBs and PCARDBs are making all efforts to implement provisioning norms in respect of doubtful and sub-standard assets on these lines.

The NPAs as on 31st March, 1998 constituted 18.63 per cent for SCARDBs and 16.53 per cent for PCARDBs. It is worth mentioning that SCARDBs for Punjab and Haryana had no NPAs. Capital to risk weighted asset ratio is an important element in the prudential norms. Although there is no prescribed ratio for SCARDBs and PCARDBs, attempt must be made to maintain a minimum capital adequacy ratio of 8 per cent in the near future.

(c) Contrary to the principles of cooperatives, the elected boards were superseded in many states and they are not in a position to function in a democratic way as a result, the professionalism in its management is affected. It is important to activate steps to restore the democratic boards at the earliest to enable active participation of elected members.

(d) Cooperatives suffer often on account of excessive state government interference leading to slow pace of changes in cooperatives including achievement of adequate governance compared to other RFIs. There is a need to give a boost to cooperative spirit to achieve a transparent cooperative policy. This would enhance the opportunity for co-operatives to function as a 'business enterprise' with social mission.

(e) The Second Narasimham Committee on Banking Sector Reforms (1998) urged that consideration be given to delayering of the cooperative credit system with a view to reducing the intermediation costs and providing the benefit of cheaper NABARD credit to ultimate borrowers. This needs a close look before a final view is taken since the issues are somewhat complex.

(f) To provide transparency, authenticity and accountability of the management to the owners and share-holders, timely statutory audit by an external professional is a must. In this direction, entrusting the statutory audit of co-operatives to Chartered Accountants on the lines of

commercial banking system will not only clear the arrears in audit, but will also set the system in the right path for sustainable development.

(g) A more conducive climate for recovery has to be built. In this, the major initiative of the recovery of dues has to come from the RFIs themselves. Innovative schemes must be drawn up including giving due weightage to recovery performances in staff appraisal. On the legal side, State Governments must assist the RFIs by instituting mechanisms for expeditious disposal of the cases filed. The Union as well as State Governments will have to resolve that no across-the-board waivers will be announced which vitiate credit dispensation.

(h) The provision of credit and the way in which credit is tailored to suit the requirements of the poor are equally important. The objective is not only the financial transfer of resources to the rural borrower but also the creation of an enduring and a responsive financial system which can continue to provide access to credit. This implies, among others, the establishment of a system of credit distribution and supervision whose costs are consistent with sustainable operations. The marginal transaction costs incurred by banks in delivering credit to the rural sector should fall. This would also help to bring about improved profitability of the ARDBs.

(i) Significant strengthening of human resources needs to be carried out in the RFIs. There is a need to review the deputation system with a view to make the system more effective and responsive to meet the growing needs of the rural sector. Rural lending requires a specific type of organisational ethos, culture and attitude. At present, this is the weakest organisational element in the growth and development of the RFIs. Appropriate and adequate attention by all concerned will have to be paid to training of personnel and technical upgradation.

(j) The exercise of development action plans (DAPs) for every ARDB and the consequent memorandum of understanding (MoU) signed among the NABARD, the State Government and the state land development bank have been the most significant institutional interventions in the recent period. Strict adherence to the agreed covenants and targets of its MoUs should help contribute in strengthening the organisational base and the operating practices of the concerned RFIs.

(k) The grassroot tiers of co-operative credit structure are the weakest and to have an efficient and vibrant co-operative credit system, revamping of the base-level institutions needs to be attempted on a priority basis.

(l) The recent South East Asian crisis clearly emphasised the need for adequate and timely availability of data. Unless necessary basic data are available, it is very difficult to assess the development and also to suggest timely remedial policy measures. In this context, I may mention that basic relevant data pertaining to cooperative banks are available after a considerable time-gap as compared to commercial banks. To site an example, all relevant basic data for the period 1998-99 are available for scheduled commercial banks whereas similar data are not available for co-operative banks. Attempt must be made to expedite this process and in this respect I hope all the offices, to the extent possible, are computerised so that ARDBs could derive full benefits of information technology. Transparency and availability of timely information facilitate markets to form their own expectations in a more rational and realistic manner.

Scope of business potential

Having gone over the issues facing ARDBs, and before concluding my address, let me mention the new areas where largely untapped business potential lies for PCARDBs and SCARDBs. This would not only augment their business but would also enable them to achieve diversification.

With the modernisation of agriculture and improved technologies, capital investment is also escalating. This will give enough opportunities for SCARDBs to intensify financing. The other areas where SCARDBs can explore the possibility of providing credit is for food processing activities. There is huge potential for business in the agriculture and agro processing sector in our economy. Furthermore, enough scope is available for financing hi-tech agriculture like floriculture where export prospects are huge.

SCARDBs can also undertake consultancy services at the apex level. It is, however, important to ensure that SCARDBs are in a position to develop necessary expertise for the purpose and attain a viable status.

Conclusion :

I thank you once again for inviting me here and wish success in your deliberations.

* Speech delivered by Shri Jagdish Capoor, Deputy Governor, RBI at Workshop on Structural Reforms in Cooperative Agriculture & Rural development Banks on 16 August 1999 at Kathmandu.