Role of Financial Sector in the Growth of the Southern Region – A Question of Balancing

Good Morning Ladies and Gentlemen!

2. The importance and the lead role of financial sector for economic development attracted the attention of economists, policy makers as well as executors. *According to Goldsmith (1969:400), "mobilizing liquid resource accelerates economic growth and improves economic performance to the extent that it facilitates the migration of funds to the best user, i.e. to the place in the economic system where the funds will find the highest social return".*

3. In the analysis of financial institutions in Schumpeter's work, banking was considered as one of the primary and essential factors for economic development. In the whole process of development, Schumpeter (1933 and 1939) regarded the banking system as one of the two key agents (the other being entrepreneurship). Given this impetus, it is worth mentioning that the correlation between bank credit and economic growth is resilient.

4. It is thus the financial system that has been tasked to intermediate to usher in efficient allocation of resources. Banking system has, in fact, become special with its main functions of mobilizing savings of public and its efficient allocation for various productive activities and providing access to those sections of entrepreneurs who are unable to find any formal financial service. In the Indian context, such allocation of resources for economic activity is done mainly by banks, but the Regional Rural Banks (RRBs), the Co-operative banks and the Non-Banking Financial Companies (NBFCs) also contribute in fulfilling this task. In India, the guidance/directions given to the banking system, with regard to the social banking in the 1970s and 1980s and with the introduction of comprehensive economic and financial sector reforms in the 1990s helped in addressing the gaps in financing economic activities. Further, the introduction of financial inclusion and the related policy

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measures initiated both by the Government of India and by Reserve Bank of India in recent decade enabled banks to reach the extra mile and not to distinguish between micro and small enterprises, street vendors, small business entrepreneurs, etc.

5. India being such a large country that it's different regions are at different states of economic development and have been growing at different speeds. Public policy does recognize this and therefore, has provisions that strategies suiting the levels and speeds of economic growth in the regions be pursued.

6. Today, I will be focusing on the 'Role of Financial Sector in the Growth of the Southern Region'. Since banks are the major players in the financial system, my talk will be centred on the role of banks for economic growth and its future prospects for the region. I have organized my talk as follows:

(a) I will briefly discuss about major economic parameters of the southern region.

(b) then I will be analyzing the linkage to growth based on (i) Deposits to GSDP (Gross State Domestic Product) (ii) Banks' Credit to GSDP (Gross State Domestic Product) (iii) C/D ratio and (iv) Urban Cooperative Banks (UCBs) in the allocation of resources for economic activities in the region (v) role of NBFCs and (vi) financial inclusion - general trend in the region.

(c) Thereafter, I will discuss the scope of the banking sector in the emerging developments of the region and what more can be done by the banks to further the growth in the region.

Economic Growth

7. During the pre - reform period of 1980s, the growth rates of the states in the southern region were generally less than the all India growth rate. During the 1990s, after the economic and financial sector reforms, these states performed better than the all-India growth rate. The growth rates were still higher, during the last 10 years or so when greater push had been given for financial inclusion. (Pl see Table 1).

Table 1: Economic Growth Rate of Southern States (Per cent)

Particulars	Pre-reform period 1980-81 to 1990-91	Post-reform period		Financial Inclusion drive 2006-07 to 2013-14
		1991-92 to 2000-01	2001-02 to 2005-06	
Andhra Pradesh	5.0	5.4	6.8	8.0
Karnataka	5.2	6.9	6.2	6.8
Kerala	2.4	5.0	7.6	7.8*
Tamil Nadu	5.7	11.6	6.3	8.6
All India	5.6	5.7	6.8	7.4
*Data relates to the period 2006-07 to 2012-13 Source: Central Statistics Office (CSO)				

Per capita income

8. Let us now look at another indicator of economic prosperity viz., per capita income. The per capita income of the region over the last three decades compared with other regions showed that this region has performed very well. In fact, during 1980s, this region's average per capita income was below the national average. During the 1990s, while Kerala and Tamil Nadu surpassed the national average, AP and Karnataka were just below the national average. However, during the 2000s, the entire region was much more than the national average. (Pl see Table 2)

Table 2: Average Per Capita Income of the Southern Region based on Net State Domestic Product (NSDP) at current prices (Amount in ₹)

States	Pre-reform Period	Post-reform Period		
	1980-81 to 1990-91	1991-92 to 2000-01	2001-02 to 2005-06	2006-07 to 2013-14*
Andhra Pradesh	2557	10673	22760	58798
Karnataka	2765	11497	23438	59053
Kerala	2586	12388	27777	61994
Tamil Nadu	2857	13020	26433	73302
All-India [Net National Income]	3364	11616	22253	51519
*Excluding 2013-14 figures of Kerala State as not available Source: Central Statistics Office (CSO)				

Banking Indicators

Number of offices

9. Let us now turn to the role played by the commercial banks as part of the financial system for the progress of the region. Commercial banks, which are involved in providing credit facilities and making investments for productive activities as well as broadening banking practices under financial inclusion, have expanded their offices across the region. The number of offices (including Regional Rural Banks) expanded in the region by moving up sharply from 17,613 end-March 1999 to 29,135 at end-March 2013 (excluding U.Ts of Pudhucherry and Lakshadweep).

Table 3: No. of Bank Offices: Southern Region

States	**Pre-reform Period***	**Post-reform Period**		
	1980-81 to 1990-91	**1991-92 to 2000-01**	**2001-02 to 2005-06**	**2006-07 to 2012-13**
Andhra Pradesh	3709	4863	5286	6754
Karnataka	3187	4483	4850	5932
Kerala	2606	3055	3399	4205
Tamil Nadu	3691	4548	5635	5481
Southern Region	13193	16949	19170	22372
All-India	49823	63032	67065	82732

Source: Figures furnished are average number of reporting bank offices worked out based on Statistical Tables Relating to Banks in India, Various Issues, Reserve Bank of India.

*Pre-reform period data excludes the years 1988 and 1989 for Southern States.

Role of banks

10. I would like to highlight the involvement of commercial banks in the development of the region. For measuring the role of banks, the following parameters have been considered by me: (a) deposits to GSDP, (b) credit to GSDP and (c) C/D ratio. The role played by banks has been analysed under these categories in terms of: (a) prior to the introduction of financial sector reforms; (b) post financial sector reform period and (c) inclusive growth period. Prior to 1991, the deposit to GSDP of combined Andhra Pradesh in 1981 was hardly 28.0 per cent, credit to GSDP ratio was 21.1 per cent and Credit to Deposit ratio was 75.3 per cent. This moved up to an impressive level of 52.8 per cent, 58.1 per cent and 109.9 per cent, respectively, in 2013, underscoring banking penetration for the growth in the combined State of Andhra Pradesh (Table 4). In fact, banks have played deeper role, even better in the rest of the region like Karnataka, Tamil Nadu and Kerala states.

Table 4: Important Banking Indicators of Performance: Southern Region (Per cent)

Year	Particulars	Andhra Pradesh	Karnataka	Kerala	Tamil Nadu	All-India
2013	Deposits-GSDP Ratio	52.8	88.6	67.0	60.0	75.1
	Credit-GSDP Ratio	58.1	63.2	49.2	73.8	58.6
	C/D Ratio	109.9	71.4	73.3	123.0	78.1
2001	Deposits-GSDP Ratio	37.6	51.3	62.3	43.2	47.5
	Credit-GSDP Ratio	23.8	30.4	26.8	39.2	27.8
	C/D Ratio	63.3	59.3	43.1	90.6	58.5
1991	Deposits-GSDP Ratio	31.8	41.3	54.6	43.1	37.6
	Credit-GSDP Ratio	26.3	35.5	32.3	43.3	24.9
	C/D Ratio	82.6	85.8	59.1	100.5	66.2
1981	Deposit-GSDP Ratio	28.0	37.1	39.8	36.8	32.3
	Credit-GSDP Ratio	21.1	28.5	28.5	35.0	22.0
	C/D Ratio	75.3	77.0	71.5	95.1	68.1
Source: Reserve Bank of India						

Urban Co-operative Banks

11. Another important institutional set up in the financial system allocating funds for economic activities is by Urban Cooperative Banks (UCBs). As at end- March 2014, a total of 557 UCBs under both scheduled and non-scheduled categories were operating in the region. These UCBs put-together have mobilized public deposits totaling ₹ 48,461.41crore as at end-March 2014 and funded various activities in the region amounting to ₹ 32,146.15 crore at end-March (Table 5).

Table 5: Profile of Urban Co-operative Banks (UCBs) – Southern Region (Amt. in ₹ crore)								
Sl. No.	**Details**	**Year**	**Andhra Pradesh**	**Karnataka**	**Kerala**	**Tamil Nadu**	**Southern Region****	**All India**
1.	No. of UCBs	2011	106	266	60	129	561	1,645
		2012	103	266	60	129	558	1,618
		2013	103	266	60	129	558	1,606
		2014	102	266	60	129	557	1,589
2.	No. of scheduled UCBs	2011	3	1	Nil	Nil	4	53
		2012	2	1	Nil	Nil	3	52
		2013	2	1	Nil	Nil	3	51
		2014	2	1	Nil	Nil	3	51
3.	No. of Non-Scheduled UCBs	2011	103	265	60	129	557	1,592
		2012	101	265	60	129	555	1,566
		2013	101	265	60	129	555	1,555
		2014	100	265	60	129	554	1,538
4.	Deposits	2011	5,180.01	13,390.06	5,521.68	4,821.40	28,913.15	211,900.00
		2012	6,373.75	16,202.36	6,948.96	5,376.74	34,911.81	238,600.00
		2013	7,830.62	19,417.26	8,445.00	6,411.95	42,104.83	276,900.00
		2014	9,000.00	21,896.48	9,970.00	7,594.93	48,461.41	308,200.00*
5.	Loans and Advances	2011	3,865.79	9,402.08	3,849.72	3,781.36	20,898.95	136,500.00
		2012	4,614.97	11,475.00	4,720.00	4,394.96	25,204.93	157,800.00
		2013	5,436.02	12,936.54	5,934.00	5,047.42	29,353.98	181,000.00
		2014	5,709.00	15,034.00	6,188.00	5,215.15	32,146.15	197,700.00*
*Figures are provisional ** Excluding UTs of Pudhucherry and Lakshadweep. Source: Reserve Bank of India								

Role of NBFCs in the Region

12. As at end-March 2014, there were 995 non-banking financial companies in the category of deposit taking, non-deposit taking and core investment companies in the Southern Region as against 12,029 for all-India. Among the states in the region, deposits taking financial companies are very active in the State of Tamil Nadu (Table Nos. 6 and 7).

Table 6: No. of NBFCs: Southern Region

Sl. No.	State	Year	Category 'A' (Deposit Taking)	Category 'B' (Non Deposit Taking)	Category 'C' (Core Investment)	New (Category 'B' from May 1998)	Total No. of NBFCs
1.	Andhra Pradesh	2011-12	2	231	Nil	33	266
		2012-13	1	199	1	40	241
		2013-14	1	186	2	39	228
2.	Karnataka	2011-12	7	102	Nil	34	143
		2012-13	7	100	3	32	142
		2013-14	7	102	3	32	144
3.	Kerala	2011-12	13	115	Nil	27	155
		2012-13	12	114	Nil	29	155
		2013-14	12	113	Nil	33	158
4.	Tamil Nadu	2011-12	37	421	Nil	39	497
		2012-13	35	395	1	37	468
		2013-14	34	391	1	39	465
5.	Southern Region	2011-12	59	869	Nil	133	1,061
		2012-13	55	808	5	138	1,006
		2013-14	**54**	**792**	**6**	**143**	**995**
6.	All India	2011-12	271	11,190	Nil	924	12385
		2012-13	254	10,982	12	977	12,225
		2013-14	241	10,810	15	963	12,029
Source: Reserve Bank of India							

Table 7: Deposit Position: NBFCs: Southern Region (Amount in ₹ Crore)

Sl. No.	State	Year	Category 'A' (Deposit Taking)
1.	Andhra Pradesh	2011-12	Nil
		2012-13	Nil
		2013-14	Nil
2.	Karnataka	2011-12	7.02
		2012-13	8.49
		2013-14	10.07
3.	Kerala	2011-12	79.39
		2012-13	80.19
		2013-14	185.41
4.	Tamil Nadu	2011-12	10,885.36
		2012-13	12,547.30
		2013-14	16,122.78
5.	All India	2011-12	12,656.41
		2012-13	15,310.67
		2013-14	20,556.20
Source: Reserve Bank of India			

13. As regards funding for economic activities, for deposit taking as well as non-deposit taking companies, lending was high in Tamil Nadu, followed by Kerala and then combined Andhra Pradesh. They have lent about ₹ 1.90 lakh crore as at end of March 2014. (Table 8).

Table 8: Loans and Advances: NBFCs: Southern Region (Amount in ₹ crore)

Sl. No.	State	Year	Category 'A' (Deposit Taking	NBFC – Non Deposit Taking Systemically Important (NDSI)
1.	Andhra Pradesh	2011-12	174.73	11,135.92
		2012-13	236.03	15,175.10
		2013-14	297.17	13,374.24
2.	Karnataka	2011-12	30.36	5,584.35
		2012-13	36.27	6,924.41
		2013-14	20.46	8,777.11
3.	Kerala	2011-12	527.81	40,715.84
		2012-13	758.96	50,288.16
		2013-14	978.41	43,445.94
4.	Tamil Nadu	2011-12	54,846.60	80,768.97
		2012-13	71,978.63	100,021.34
		2013-14	79,990.08	111,482.55
5.	All India	2011-12	90,593.94	639,480.36
		2012-13	101,102.27	760,039.01
		2013-14	136,404.30	844,835.69
Source: Reserve Bank of India				

Financial Inclusion in the Southern Region

14. In India, even today, we have a huge slice of our populace, comprising mainly less privileged people that remains largely excluded from the formal financial system. In order to take the banking service to the so far financially excluded society, constant and special measures have been taken by the Government of India and the Reserve Bank under the 'Financial Inclusion' programme whereby a roadmap has been set to achieve 100 per cent Financial Inclusion in the entire country.

15. Accordingly, the Reserve Bank, in January 2006, permitted banks to engage Business Correspondents (BCs) and Business Facilitators (BFs) as intermediaries for providing financial and banking services. Reserve Bank has also from time to time enlarged the list of eligible individuals / entities

who can be engaged as BCs. The BC model allows banks to provide door step delivery of services especially cash in – cash out transactions at a location much closer to the population, thus addressing the last mile problem.

16. In our efforts to achieve sustained, planned and structured financial inclusion, we have advised all public and private sector banks to put in place a Board approved Financial Inclusion Plan (FIP) to achieve the target latest by March 2016. In addition, we have asked banks to integrate approved FIPs with their business plans and to include the criteria on financial inclusion as a parameter in the performance evaluation of their staff.

17. As a result, banks have made further stride in providing banking services to the people. I am happy that commercial banks under 'Financial Inclusion' agenda are moving in tandem with the target in the entire Southern Region. While the villages under population above 2000 have been covered, the process for ensuring complete coverage of villages with population below 2,000 is progressing well.

18. As per CRISIL's financial inclusion index called *Inclusix*, which covers three parameters of branch penetration, deposit penetration and credit penetration, on a scale of 100, the highest financial inclusion of 66.1 points has been achieved by the Southern Region in 2012, as against 42.8 for all-India. This also indicates that more extension and expansion of the country as a whole, and even in this region.

What more for the region – A Balancing Act?

19. Let us now discuss what more the banking system can do for the region. There are several expectations by the region out of the banking system and there are several compulsions on the banking system. Further, there are certain peculiar specialities in this region. A standard response by the banking system will be to skip these. In my opinion, the banking system

should, instead, find a fine balance between managing these peculiarities and adhering to set best practices.

- First of course, is that the region expects continued support from the banks for its growth lead to be maintained. That is, the region expects to maintain the more than 100% CDR. While the banking system will be willing to be partnering this, it will have to do so by balancing the expectations from the rest of India. Every region competes for greater flow of credit and financial services and the banking system has the responsibility in addressing this.

- Second, this region is susceptible to vagaries of nature and natural calamities strike this region in a severe way, affecting especially the agricultural sector. Maintaining steady flow of credit to the agricultural sector is a challenge. Complicating this is the ineffectiveness of agricultural insurance. This region has the peculiar, but popular, habit of gold loans smothering the agricultural loans. In that process, the farmers do not get the benefits of agricultural insurance. The banking system has to find a solution for this vexed problem of balancing their need to secure their interests vis a vis the protection for the farmers. I will return to discuss another variant of this gold loan related problems in a minute.

- Third, like any other region, this region also wants increased flow of credit for the Micro, Small and Medium Enterprises (MSME) sector. As is well known, despite continuous increase in the bank credit for the MSME sector, the formal credit flow for this sector is very meager compared to the enormous number of units in this sector and the banking sector should tap the great potentials of this sector. The biggest hurdles facing the banking system are its requirements of documentation, its traditional models of assessing the credit needs of the MSMEs and many a time, the gap in the attitude and sensitivity of the bank officials. It is heartening to note that the non-banking financial companies (NBFCs) in this region have found a balanced answer to skirt around these hurdles and their flow to this sector has recorded good growth in recent times. Perhaps, the banking sector can also find such a balance.

- Fourth, another speciality of this region is the preponderance of non-formal and informal, but riskier avenues for savings. This region is replete with history of the so-called blade companies, varieties of formal and informal chit funds, ponzi schemes, emu farms and other types of attractive schemes. These schemes have time and again captured the imagination of gullible, and even not-so-gullible people of this region, very often lured them into losing their hard earned savings. These ever running episodes only clearly establish the failure of the formal financial system, including the banking system, in catering to the savings, investment and risk taking needs and appetite of these masses. They very pithily indicate that there are savings to be mobilised in an orderly manner; and there are people whose risk appetite is more than ordinary or normal and the formal financial system can offer them well regulated risky financial products. The banking system should come out with innovative and customized savings and financial products. This way they can balance their business opportunities with the niche needs of these people in the region.

- Fifth, another speciality of this region is very note worthy and heartening. That relates to the number of Self Help Groups (SHGs), especially of the women which operate in this region. In fact, the southern region leads by leaps and bounds in this respect. The readiness, the enthusiasm and the dedication and discipline of these women SHGs are the backbones of their success. In the wake of their successes, certain unhealthy practices and certain overreactions to them had resulted in a slowdown, even in stoppage of credit flow to this segment. Further, quite many SHGs, before they have matured enough to handle credit and finance, have been exposed to credit. Concomitantly, the credit discipline that had been assiduously built painstakingly over the years has been ruptured. Restoring that spirit, while ensuring continued flow of credit is another balance the banking system has to find.

Conclusion

20. Now, to conclude, we have seen how the regional economy did a turnaround in the post reform and financial inclusion period as compared to the pre-reform period; the regional economy has not only posted better growth but also has surpassed certain all-India numbers. We also saw how the banking system has, by allocating the mobilised resources, contributed to the steady and sustained economic growth of the region over the last three decades. We have also seen the role played by the urban cooperative banks and the non - banking financial companies in providing access to financial products and services and helping in allocation of credit. Finally, we discussed some peculiarities and specialities of the region and their impact on the banking operations and how banks need to undertake a tightrope balancing while handling these peculiarities.

21. Thank you one and all for your kind attention.

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