

CO-OPERATIVE RURAL BANKS – A SUCCESS STORY?

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Dr. Nimal Sanderatne has developed his interest in the rural financial and agricultural sectors over nearly three decades. He has written authoritatively on these areas and some of his specialised writings have appeared in the Economic Review, from as far back as April 1975. He was a former Director of Economic Research, Central Bank and is at present Chairman, Bank of Ceylon.

Twenty five years ago the People's Bank launched a new institutional means for improving financial intermediation in rural society – the Co-operative Rural Banks. The rationale for establishing these Co-operative Rural Banks lies in both the nature of the rural economy and the difficulties of establishing viable branches of commercial banks in rural areas. A Co-operative Rural Bank is also a more suited institution for rural society owing to its limited area of operation, its less imposing edifice and its already established relationship with, and intimate knowledge of, customers through the co-operative.

The importance of establishing institutions to mobilise savings was expressed very clearly a few years before the establishment of rural banks by Professor Edward Nevin:

"The tasks of financial institutions in an underdeveloped territory are therefore almost self-evident. In the first place, their purpose is to provide a collecting point for savings of a relatively small average amount, from a large number of individual sources. So long as the means to utilize savings safely and profitably are not available within an economy, funds will either be diverted abroad, sterilised in useless hoards of cash or precious metals, or, more likely still, will not accumulate at all. However, poor an economy may be there will be a need for institutions which allow for such savings as are currently forthcoming to be invested conveniently and safely, and which ensure that they are channelled into the most useful purposes. The poorer a country is, in fact, the greater is the need for agencies to collect and invest the savings of the broad mass of persons and institutions within its borders."¹

1. Edward Nevin, *Capital Funds in Underdeveloped Countries, the Role of Financial Institutions*, London 1961.

Rural banks were expected to serve this objective, Nevin discussed above as well as be a means of providing finances for the needs of rural borrowers. A fulfillment of the latter objective would imply a reduced role for informal lenders, particularly money lenders who charge very high rates of interest, an increase in the supply of credit and better conditions of borrowing. The establishment of rural banks in 1964 could be considered an important step in expanding the institutional means of mobilising savings, expanding credit in the country and providing some of the services of commercial banks to remote areas which would not have had such facilities otherwise.

Factors Favouring Rural Banks

Rural banks were therefore envisaged as a means of extending even limited banking and credit facilities to areas whose conditions do not justify the extension of the branch banking system. It was also considered a means of combining the advantages of a unit banking system, such as personalised knowledge of the clientele and local conditions, with the advantages of a branch banking system, which enables the transfer of resources between difficult areas and a greater security and stability of funds.

From the point of view of a commercial bank a rural bank is much less costly to operate than a branch of a commercial bank. The costs of operating a branch bank being high, the limited operations in a rural bank area necessitates the provision of banking facilities at lower costs for making the unit financially viable. On the criterion of financial viability most rural bank areas would not have been served with any commercial bank branches. In contrast to a commercial bank branch a rural bank is often housed in the co-operative society building and engages persons on its staff who are paid lower salaries than regular People's Bank staff members. The choice in these areas is between limited banking facilities as provided by rural banks or no facilities at all.

From the point of view of the rural clientele the provision of even limited banking facilities by a local and familiar institution may be preferable to a more imposing but less comprehensible type

of institution. In fact most rural people could be intimidated by conventional bank branches and consequently would not have a capability to mobilize the savings of most rural people. They may dole out some finance to farmers under special agricultural credit programmes, but they will not really have a rural clientele who have confidence in their bank. The personal acquaintance of rural bank personnel and the operation of the bank at times convenient to the clientele are advantages of particular significance in the rural context of limited familiarity with institutional savings and credit organizations.

The introduction of even a rudimentary form of banking was considered a useful educative experience to a rural bank's clientele, who would gain a familiarity with banking procedures. The development of banking habits, particularly of depositing excess cash holdings and the responsible management of an account, was expected to create a responsible clientele to whom fuller banking services may be extended. Further, the operations of a rural bank would provide a basis on which it could be decided whether fuller banking services should be extended in the area either by the extension of the branch banking network or the expansion of the rural bank's activities.

During the initial experimental phase rural banks were set up only in co-operative societies, which had functioned for a minimum of three years, had a strong membership which had paid their share capital regularly; a good loan repayment record and running at a profit. Most co-operative societies selected to run rural banks had implemented the People's Bank's Extended Credit Scheme.

At the end of 1966 only 13 rural banks had been established but they increased to 111 at the end of December, 1971. After 1972 the number of rural banks increased rapidly due to the reorganisation of Multi-purpose Co-operative Societies, and the government decision to attach a rural bank to each of the reorganised Multi-Purpose Co-operative Societies. It was after 1972 that rural banks came to be named "Co-operative Rural Banks". During 1972 alone 131 new rural banks were established and 111 of them were set up in the first quarter of the year. In order to implement the government decision to channel loans under the Comprehensive Rural Credit Scheme through rural

banks, the number of rural banks was increased from 242 at the end of December 1972, to 341 within the next year.

The number of Co-operative Rural Banks declined to 332 at the end of 1974 due to the amalgamation of some as a result of the reorganization of Multi-Purpose Co-operative Societies. Yet in the same year, special branches of the Co-operative Rural Banks were opened in the 'pradeshikas' of the Multi-purpose Co-operative resulting in a further expansion of the rural banking network. These special branches perform the same functions as Co-operative Rural Banks.

TABLE 1

EXPANSION OF CO-OPERATIVE RURAL BANKS - 1964-1988

Year (as at end December)	No. of Co-operative Rural Banks	No. of Special Branches	Total
1964	3		3
1965	8		8
1966	13		13
1967	27		27
1968	44		44
1969	68		68
1970	70		70
1971	111		111
1972	242		242
1973	341		341
1974	332	71	403
1975	338	109	447
1976	345	158	503
1977	285	259	544
1978	284	275	559
1979	284	302	586
1980	284	357	641
1981	287	459	746
1982	286	518	804
1983	288	555	843
1984	286	602	888
1985	286	628	914
1986	283	649	932
1987	282	673	955
1988	282	686	968

The progressive expansion of Co-operative Rural Banks during the 25 year period may be assessed from Table 1. The network of Co-operative Rural Banks expanded quite rapidly, particularly after 1972. The number of rural banks increased to 332 at the end of the first decade in 1974, to 888 at the end of the second decade, and on its twenty fifth anniversary has reached nearly 1000. At the end of 1987, aggregate

rural banking institutions under the Co-operative Rural Banking Scheme reached 955: 282 Co-operative Rural Banks and 673 Special branches. There is little doubt that there has been a very rapid expansion of Co-operative Rural Banks which have exceeded in number the commercial bank branches in the country.

Rural banks are also fairly well distributed throughout the country on the basis of the district population, areas and the availability of other banking facilities. The geographical distribution of Co-operative Rural Banks is given in Table 2.

It is generally presumed that rural areas have low potential for savings mobilisation and consequently the establishment of such institutions is expected to result in these institutions granting credit in excess of the savings they could mobilise. The experiences of Co-operative Rural Banks have proved this presumption incorrect. After the first 5 years of their operation when there was an annual overall deficit, in the subsequent years, excluding 1974 and 1975, Rural Banks as a whole mobilised a larger amount of savings than the amount of funds they advanced for both short term lending and pawning. By 1970 Rural Banks had a surplus of Rs.7.8 million, in 1980 it had risen to Rs.191.6 million and at the end of 1987 the surplus had increased to Rs.851.4 million. At the end of 1987 Co-operative Rural Banks in all districts except Trincomalee had an excess of deposits over advances.

While the expansion of rural banks to around 1000 and its distribution fairly widely in the country and the amount of savings mobilised by them may be considered satisfactory, its function as a provider of funds for rural development has been very limited. Rural banks have demonstrated clearly the ability to mobilise small savings from among rural society, but its record of lending shows very limited activity particularly when the pawning component of lending is excluded. Advances excluding pawning have been limited to only Rs.337.8 million at the end of 1987. The amount lent on pawning was Rs.371 million. The surplus of deposits over total advances including pawning was Rs.851 million.

TABLE 2

CO-OPERATIVE RURAL BANKS - DISTRICT WISE DISTRIBUTION 1987

District	Co-operative Rural Banks	Special Branches
Colombo	59	69
Gampaha	94	97
Kalutara	46	47
Kandy	77	77
Matale	23	22
Nuwara Eliya	27	29
Galle	69	72
Matara	65	66
Hambantota	25	25
Jaffna	36	36
Mannar	08	07
Vavuniya	06	06
Batticaloa	10	10
Ampara	28	28
Trincomalee	13	13
Kurunegala	96	96
Puttalam	35	35
Anuradhapura	39	39
Polonnaruwa	28	28
Badulla	53	53
Moneragala	09	09
Kegalle	49	49
Ratnapura	60	60
	955	968

More than one half of short term loans has been for electrification of houses and water supply. Loans for agricultural production and cottage industry amounted to only about 20 percent of advances. It must of course be accepted that money obtained by pawning could have been utilised for a variety of purpose including productive enterprises. The purpose wise distribution of short term advances in 1985-87 is given in Table 3.

This deficiency in lending was highlighted several years ago by an FAO team when it said that the rural banks "unit banking functions have not been developed in the rural sector to the point of harnessing extra local resources for local rural development - this is evident in the consistent and increasing excess of rural deposits over rural advances." 2

2. Report of the High Level Mission on the follow-up to the World Conference on Agrarian Reform and Rural Development in Sri Lanka. The Food and Agricultural Organisation of the United Nations, 1980, p.34.

TABLE 3

PURPOSEWISE DISTRIBUTION OF LOANS BY CO-OPERATIVE RURAL BANKS

Purpose	Amount out- standing as at end 1985		Amount out- standing as at end 1986		Amount out- standing as at end 1987		Amount out- standing as at 30.09.89	
	Amount	%	Amount	%	Amount	%	Amount	%
1. Production of which	53.8	23.0	60.5	20.5	66.9	19.8	93.6	24.3
1.1 Agriculture	33.7		32.4		33.2		58.6	
1.2 Animal Husbandry	9.4		11.6		15.1		15.9	
1.3 Cottage Industry	10.7		16.5		18.6		19.1	
2. Housing Electrification and Water Supply	133.4	57.0	176.2	59.7	198.2	58.7	225.2	58.9
3. Debt Redemption	15.2	6.5	17.8	6.0	19.8	5.9	19.9	5.3
4. Consumption	7.3	3.1	8.4	2.8	10.9	3.2	10.4	2.8
5. Trade and other	24.4	10.4	32.4	11.0	42.0	12.4	33.0	8.7
Total:	234.1	100.0	295.3	100.0	337.8	100.00	382.1	100.0

The Central Bank has also pointed this out regularly in its Annual Reports and Review of the Economy. For instance in the Review of the Economy for 1985 it said "Unless Rural Banks make an effort to play a more active role in providing credit to the rural sector, they will continue to be merely a channel through which resources are transferred out of the rural sector to the urban centres."³ In fact it was the inability of the co-operative rural bank to lend adequately for small enterprises which led the Central Bank to devise the system of Regional Rural Development Banks which were inaugurated in 1985.

The inability of Co-operative Rural Banks to increase their lending is undoubtedly due to several reasons. First and foremost is the fact that the local community may not in fact have viable economic enterprises for financing. The promotion of such enterprises require skills, market possibilities and entrepreneurial abilities. Mere finances will be inadequate. Therefore, these prerequisites for economic enterprises would require to be established for the finances to be utilised.

Even within the context of the given opportunities for lending, it is likely that the staff of the Co-operative Rural Bank is not geared to take risks and find it much easier to lend only where there is complete security. Such as in pawning. Lending based on projects and their viability may not find favour among the staff who may not be acquainted with the methods of appraisal nor even have the kind of orientation and commitment to encourage such lending.

In an assessment of Co-operative Rural Banks, Olcott Gunasekera has said "It may be true to say that rural banking in the limited sense of rural savings mobilisation through Co-operative Rural Banks has been successful. But in the overall development of the rural economy, rural banking has failed to make an appreciable dent".⁴ While this deficiency has been highlighted of the past performance, the new perspective to development with the Government's Jana Saviya Programme could provide the basis for using Co-operative Rural Banks, an already established institution, to re-orient themselves to lend to small scale employment and income generating enterprises. To use the net work of

Co-operative Rural Banks it would be necessary for the other government organisations which are involved in the Jana Saviya Programme to work out the enterprises for financing and recommend these to the Co-operative Rural Banks for their funds. This strategy is similar to the one adopted by the Central Bank through its regional offices where projects are identified by the Central Bank Regional Office and recommended for financing to the commercial bank branches in the area.

On this twenty fifth anniversary of the establishment of Co-operative Rural Banks, it is appropriate to recapture the reasons which motivated their establishment. It was recognised that while increasing the number of bank branches is necessary and important, that this alone was inadequate. There was a need for qualitative adaptations in institutions to suit rural conditions. The type of banks

or other credit institutions established should be suited to the rural folk, the poor and less educated clientele. If branch banks in rural societies are of the same type as urban banks and use the same approaches in their banking, then it is likely that such banks would attract only prosperous customers such as land owners, traders and merchants, rather than the larger number of ordinary rural folk. It was recognised that bankers should go out to their rural customers rather than expect rural folk to come to them.

The development of financial institutions to serve the rural sector is not an easy task. Twenty five years ago when the first rural bank was established, it broke a tradition and was an innovative means of reaching a section of the community which had little access to the banking system and to which the banking system had difficulty in extending their activities. The Co-operative Rural Banks have been a useful instrument for savings mobilisation, it has now reached a stage when it would require to adapt itself to being a more dynamic instrument for financing enterprises within the local community rather than be only a means of savings mobilisation and an instrument for the transmission of funds from rural areas to developed sectors.

3 Central Bank of Sri Lanka, Review of the Economy, 1985, p.49.

4, Olcott Gunasekera, "Relations with the Co-operative Sector - a Metamorphosis from partner to favoured customer", in People's Bank, In Retrospect: 25 Years of the People's Bank, p. 59.