

## EXPLORING INVESTMENT POTENTIAL IN THE RURAL AREAS: WHITHER CRBS

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The Co-operative Rural Banks (CRBs) in Sri Lanka, celebrate their 25th anniversary in March 1989. When this scheme was inaugurated in 1964, the rural sector of the country was cut off from the Institutional Financial operations. However, CRBs acted as a harbinger of basic banking practices to the rural countryside. Though the approach of the CRBs in the first few years was rather cautious, wherever they were in operation, these banks managed to survive the financial system within their vicinity. Manikhinna, CRB could be one such example. However, by the early 1970's the CRB scheme had moved into high gear. Its branch network grew; deposit volume expanded; and its invest-

ment pattern diversified. By 1976, CRBs registered a branch network of 503 offices, having deposits amounting to Rs.116.2 million and advances worth Rs.101.7 million.

The post 1977 era, registered a crisis situation in the CRB system, not because these branches were unprofitable, but because they have been constantly accused of siphoning rural funds to finance urban ventures. This was despite the very high growth rate of branches, deposit accounts, deposit volumes, and advances. For instance, by the end of 1988, the CRB Branch network reached 968, and their total deposits exceeded Rs.1.8 billion. About 65 percent of these deposits have been invested in the commercial banking system of the coun-

### GROWTH OF RURAL BANKS IN SRI LANKA

YEAR	NO. OF RURAL BANKS	TOTAL DEPOSITS Rs.	TOTAL ADVANCES Rs.	INVESTMENTS IN THE OTHER BANKS Rs.
1965	8	496,360	1,167,265	(670,905)
1966	13	725,791	1,753,604	(1,027,813)
1967	27	1,371,313	2,662,689	(1,291,376)
1968	44	3,333,328	4,446,344	(1,113,016)
1969	89	6,173,145	5,395,927	777,218
1970	90	16,908,586	9,102,279	7,806,307
1971	111	17,864,410	9,316,647	8,547,763
1972	242	23,320,318	15,184,913	8,135,405
1973	341	45,154,631	38,912,146	6,242,485
1974	403	62,734,400	67,406,770	(4,672,370)
1975	447	74,214,009	87,285,572	(13,071,563)
1976	503	116,289,077	101,792,546	14,496,531
1977	544	175,462,249	110,883,300	64,578,949
1978	559	222,146,023	125,078,000	97,068,023
1979	586	271,003,019	129,251,000	141,752,019
1980	641	358,354,024	176,699,000	191,655,024
1981	743	434,046,015	271,596,000	162,452,015
1982	804	541,483,024	329,277,000	212,206,024
1983	840	683,444,717	361,261,007	322,183,710
1984	888	965,490,225	508,246,093	457,244,132
1985	914	1,087,536,439	574,811,379	512,725,060
1986	932	1,295,597,828	657,775,183	637,822,645
1987	955	1,560,178,455	708,781,964	851,396,491
1988	968	1,832,051,929	764,598,077	1,067,453,852

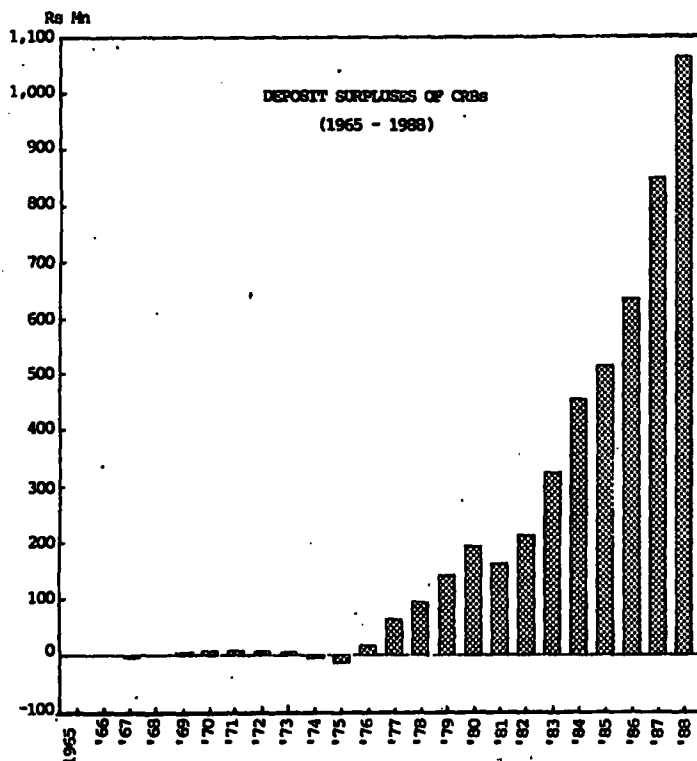
try, showing the extent of resource extraction process from the rural sector. (See Table 1).

Has the CRB scheme failed to achieve its objectives? Has it forgotten its intended functions and invested its resources to finance elitist operations in the centre? Has it become a creator of the development of underdevelopment in the rural sector? These are some of the serious allegations against the CRB system, and also against its creator "the People's Bank". However, they cannot be properly understood, without shedding adequate light on the socio-economic contours of the country within which these banks were operating. This paper, attempts to explore the underlying reasons for the build up of surplus deposit funds of the CRBs, particularly since the mid 1970's.

Some of the recent studies have disclosed that the occurrence of surplus deposit funds of the CRBs is the natural outcome of the changes in the environment, and changes in the internal structures of the CRB system itself. Hence, the underlying reasons namely exogenous, and endogenous.

The exogenous reasons, refer to the socio-economic contours of the Sri Lankan economy. They are basically manifestations of the socio-economic and political conditions of the rural economy, and its relations with the other sectors. Neither the CRBs nor the entire banking system enjoy adequate leverage over their influence. The present position of surplus deposit funds of CRBs is an end result of a continued and consistent historical process, perhaps dating back to 1975 (See Graph).

The effects of the 1977 reforms notwithstanding some of their positive features have had a strong negative influence on the investment market of the CRBs. The liberalization of trade and exchange controls exposed the hitherto captive domestic market for agricultural producers of agricultural products (eg. chillies, onions, dhal etc.) cottage industries (eg. sugar, textile, paper milling) and handicrafts (eg. batiks, mask making, etc.) to ruthless wetting of market forces. The changes in the rules of the market, such as price, profit, consumer sovereignty criteria etc. were new to the rural producers and they could not withstand the sudden withdrawal of state patronage and shelter. Consequently these products became highly uneco-



nomical in the newly created competitive set up in which they had to compete with imported substitutes. Few survived; but the majority fell.

The sudden reversal of the internal terms of trade penalized farmers, rural industrialists and artisans. Products from the centre, whether they be imports or otherwise, invaded the hinterland, and they replaced many local substitutes. The centre was superior and more profitable and hence attracted investments. Investors were quick to read this market, and even rural entrepreneurs shifted their investment patterns in favour of urban based products. Incentives such as guaranteed prices, fertilizer subsidies, etc. have not been adequate to set-off the effects of this initial shock. Consequently, ventures financed by the CRBs, during the pre 1977 era found their market shrinking and their prices contracting; and investment in these ventures became no longer attractive. Hence, the so-called adverse internal terms of trade effect was the primary reason for CRB surpluses.

In the meantime, rural deposits grew at a faster rate because of the increased direct financial flows that went to the rural sector, through state projects on housing, construction, roads, irrigation, power etc. In addition, West Asian repatriates funds, and higher prices fetched by small holders for cash crops increased the liquidity in the rural areas. However, because the rural sector was not attuned to absorb these funds, there wasn't a recycling re-investment pro-

cess. Conversely, the interest rate policies of the state had been very favourable for deposit makers, as the deposit rates within the banking system exceeded 20 percent per annum. Given the gloomy investment climate in the rural sector, the prospective investors resorted to deposit making. The high priced deposits naturally increased the price levels of advances, and thereby contracted the rural investment market still further. This process of deposits exceeding advances became a common phenomenon in the banking scenario. This was amply demonstrated by drops in the call market rates, in the subsequent years. During this period, it was not only rural banks but also the other banks having branches in the rural sector that had to suffer from the problem of deposit surpluses.

The approach of the centre to this problem was rather piece meal. The emphasis was not on why things went wrong, but how the volume of advances could be increased. For this to be achieved, more and more institutions, instruments and schemes were introduced. As a result, banks, branches and credit schemes proliferated. The situation was further aggravated by the insecure investment climate in the country, particularly after 1983. While the number of opportunities available in the difficult areas got cut-off from CRB operations, the suspension of pawn-brokering business in branches located in the sensitive areas also reduced the level of operations. It is within this investment climate that the internal pit-

falls of the CRBs and the related system should be examined.

The second group of reasons classified as endogenous variables, include those falling within the manoeuvrability of the MPCs structure. This covers the broad matrix within which the Multipurpose Co-operatives Societies (MPCs), CRBs, People's Bank and the Department of Cooperative Development (DCD) operate. Hence, this group of variables are associated with organizational structures, and management style, methods, systems and procedures followed by CRBs in carrying out their operations. It has been found that the influence of these variables were more significant determinants of the behaviour of deposits, advances and surplus deposit funds, than the exogenous variables.

As regards the organization structure of the CRBs, the distinction between the pre-reorganization structure and post-reorganization structure (1972), needs to be given adequate emphasis. The present matrix of structures of the CRBs and the importance attached to various actors within these structures can be seen as a direct outcome of the reorganization of MPCs. Some of the relevant changes that have contributed to the present position of the CRBs were:

- (1) Elimination of importance attached to CRBs within the organization structures of MPCs.
- (2) Downgrading of the strategic role played by the People's Bank in influencing decision making and management functions, inclusive of the supervision of CRBs.
- (3) Downgrading of the importance attached to the staff of the CRBs within the broad MPCs.

Prior to the reorganization, the CRB enjoyed an autonomy and independence to function as a "rural banking institution." It was expected to maintain its own accounts and the management of each CRB was made accountable for its performance. This separation of functions, performance, and reporting methods gave the CRB its own identity and the manager of the CRB reported directly to the governing body or the Committee of management of the MPCs. However, after the reorganization of CRB branches, special branche-

proliferated and in each MPCS, a post of Credit and Marketing Manager (CMM) was created (to report) to the General Manager of the MPCS on credit and marketing related operations. The introduction of two altogether different layers between the CRBs and the Board of Directors of the MPCs downgraded the importance of CRB related operations at the apex level of the MPCs structure.

The post of CMM was later changed to Banking Services Manager (BSM), who was responsible for inspecting mortgaged property, sanctioning of credit and recommending credit limits to the governing body at the MPCs level. Each BSM, has about two to five CRB branches or special branches under his control and in most places the level of loan processing and promotions of CRB branches depend on the charisma and effectiveness of the BSM. However, given the very low exposure of BSMs to credit operations and promotions, together with relatively low morale arising from meagre wage structures, it seems to be very unrealistic to expect an exceptional performance standard from these BSMs.

Below the BSMs, were the branch managers who were paid very low salaries (despite the recent revision made in some MPCs), particularly when compared with the industrial standards. These employees have often been interchangeably used to perform various other functions in MPCs retail shops and MPCs offices. Therefore, although CRB operations contain quite a high element of banking functions — which is a specialised trade the present structure does not appear to be conducive for a growth of banking cadres for CRB operations. Therefore, with the existing staff relations, reporting systems and low incentives and wages it is very unrealistic to expect CRB staff to work on their own to find investment avenues within the rural economy; particularly when low risk, and high yielding opportunities are available outside the system.

Related to this factor has been the very high concentration of work at the BSM level. For instance, the BSM of the Ambalangoda MPCs, who had five CRBs under her supervision in 1986 had to scrutinize about 100 loan applications each month. She had to travel very widely for which no adequate compensation was provided. In general the BSM's work is hardly ever appreciated by his/her superiors.

The procedural delays involved in the approval of credit limits and the absence of flexibility in formalities has been another important pitfall of the CRB credit schemes. It was observed that an approval of credit facility takes about six weeks and sometimes, loan registers of CRBs show examples of much more extreme situations, all of which discourage prospective borrowers from coming to the CRBs. This aspect of delays and resultant high transaction costs has been widely discussed in the rural credit literature, and despite their inherently simple structure of operations, CRBs still seems to have fail to provide an acceptable solution to overcome this situation of high costs.

One of the responsibilities of the CRB staff as envisaged in the original documents has been the preparation of a comprehensive credit package; and this requires the conduct of regular area surveys to ascertain credit needs in order to prepare a credit plan for the area. The economic information sheet of the membership is used to obtain basic information required to assess credit requirements of the membership. However, in practice the ability and the capacity of the CRB staff to meet the above requirements appears to be quite limited and often far below expectations.

One of the most serious impediments to Rural Credit (See page ). from CRBs to the rural sector is the stringent eligibility criteria employed by them. It starts from the question of membership. Credit facilities, other than pawn brokering, can only be accessed by those who have obtained membership in CRBs. The size of loans obtainable also has inter-alia, been a function of the numbers of shares owned by the loan applicants. In practice, obtaining as well as continuation of active membership seems to be a more rewarding exercise to many of the villagers. CRBs encourage any person seeking to open deposit accounts, and collect any amount as deposits. However, only those individuals having membership could obtain credit facilities, which gives rise to a greater number and volume of deposit accounts than the number and volume of loan accounts (advances) maintained by them. For instance, in the case of the four CRB branches observed in the Galle district, the number of deposit accounts amounted to 10,269 while the total number of loan accounts, exclusive of pawning accounts, amounted to a meagre 764.

In the meantime, the non member deposit accounts constituted 7,363 accounts or 75 percent of the total number of deposit accounts maintained by the CRBs. Hence, if the surplus deposit funds of CRBs is an unforgivable sin, why should it not be rectified by enforcing a law, preventing the CRBs from accepting non-member deposits. Are not the CRBs fulfilling a national obligation by giving rural depositors an opportunity to obtain a better and low risk yield for their deposits? Alternatively, non members can be made eligible for different types of credit facilities offered by the CRBs. The intricacies of such a change, however, needs further examination.

One of the other reasons that have influenced the investment potentialities of the CRB funds include the hostile external environment. Rural resources are said to be unorganized and fragmented. For instance, land based investments are hampered by the land holdings that are small, fragmented and full of tenurial complications. Land is the principal source of income and also the principal source of security.

However, because land titles are unclear; their use as an investment base becomes very poor, and CRB staff tend to get unnecessarily cautious when lending to rural customers. The implications of this setting have been disastrous. Firstly, it has constrained the investment opportunities in the rural areas and thereby promoted shiphoning of rural funds to the centre. Secondly, it has also increased the involvement of intermediary parties to influence credit decisions. These parties include various pressure groups, and their influence on many occasions lead to gross violation of banking ethics, and eventually credit discipline. The net outcome is an overwhelmingly high default rate, which disqualifies both borrowers and their guarantors from any further credit.

This paper attempted to disclose some of the unpalatable truths about CRB operations, particularly with regard to their high level of surplus deposit funds. However, it does not, in any way, mean to belittle the services rendered by the CRBs on various other fronts. CRBs in fact have lit many candles to dispel the darkness of debt stricken rural areas.