IFAD Regional Grant Project
"Documenting Global Best Practices on Sustainable Models of Pro-Poor Rural Financial Services in Developing Countries" (RuFBeP Project) implemented by APRACA

2nd Dissemination Workshop
22-24 March 2017; Lombok, Indonesia

Technical Session: Regional Perspective (South Asia) on Innovations in Rural and Agricultural Finance

NABARD

Resource Speaker: S.V. Sardesai,
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NABARD

National Bank for Agriculture and Rural Development (NABARD)

MISSION

"Promote sustainable and equitable agriculture and rural prosperity through effective credit support, related services, institution development and other innovative initiatives."

Our initiatives are aimed at building an empowered and financially inclusive rural India through specific goal oriented departments which can be categorized broadly into three heads: Financial, Developmental and Supervision. Through these initiatives we touch almost every aspect of rural economy. From providing refinance support to building rural infrastructure; from preparing district level credit plans to guiding and motivating the banking industry in achieving these targets; from supervising Cooperative Banks and Regional Rural Banks (RRBs) to helping them develop sound banking practices and on-boarding them to the CBS platform; from designing new development schemes to the implementation of Government of India's development schemes; from training handicraft artisans to providing them a marketing platform for selling these articles.

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(Salutation and greetings to dignitaries, speakers and delegates)

It is my great pleasure to present this discussion paper on Innovations in Rural and Agriculture Finance with South Asia perspective.

I. Introduction

To quote Jamie Notter, the famous author/speaker, "*Innovation is change that unlocks new values*". However, it is not only about the idea for change, but, it's about making the idea happen. This is more pertinent in the case of taking financial services to large number of small farmers and agri-entrepreneurs in the South Asia region.

South Asia or Southern Asia is a term used to represent the southern region of the Asian continent. As per the World Bank regional classification, the territories of Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka form the countries of South Asia.

Bangladesh, India and Pakistan form the Central Region of South Asia. Nepal and Bhutan are mountainous countries in the north, whereas Sri Lanka and Maldives are island nations in the south.

The term "Indian subcontinent" describes a natural physical landmass in South Asia that has been relatively isolated from the rest of Eurasia and it includes the above mentioned countries excluding Afghanistan.

For the purpose of this discussion we will confine to the Indian Subcontinent.

The Indian Sub-continent covers about 4.5 million km^2 (1.8 million mi^2), which is 9.87% of the Asian continent or 2.91% of the world's land surface area. The population of South Asia is about 1.72 billion or about one fourth of the world's population, making it both the most populous and the most densely populated geographical region in the world. Overall, it accounts for about 42% of Asia's population (or over 24% of the world's population) and is home to a vast array of people.

In terms of World Bank Poverty headcount ratio measured at $1.90 a day (2011 PPP), 15.09% of the population in South Asia is below the poverty line. Translated into numbers, it means 259.54 millions of people are poor. Worldwide an estimated 800 million people fall under the poverty line of $1.90 per day. In other words, a sizable number (approx. 35%) of world's poor live in South Asia.

The GDP for the region including Afghanistan was USD 2.69 trillion in 2015 (Source: data.worldbank.org). India is the sub-regional giant with a GDP (over $2.1 trillion followed by Pakistan with 0.27 trillion) and population size (over 1.31 billion), as well as land area, which far outweigh any other country in the sub-region. Sri Lanka, Bhutan and the Maldives clearly have greater progress in per capita GDP. At the same time, Bangladesh, Bhutan and Nepal are classified as less developed countries. India & Pakistan fall somewhere in the lower middle.

The largest proportion of the region's poor live in rural areas. They tend to live in remote areas that are great distances from the nearest markets and basic banking services. Agriculture is predominant employment provider in this part of the world. Its share in the national economy, though varies, is substantial. In India 54.6% of the population is engaged in agriculture and allied activities (census 2011) and it contributed 17% to the country's Gross Value Added in 2015-16 as per Government data. In Pakistan it is estimated as 21 percent to the GDP and provides employment to nearly 43 percent of the workforce; similarly for Bangladesh 16% & 48% and Sri Lanka 18% & 33%. For Bhutan, it is 15% & 60% respectively.

The best way to tackle rural poverty is to increase agricultural production and productivity. Rural credit can and does play an important enabling role. Financial innovations need to address the issues of enhancing productivity of the agriculture sector and its access to markets for better returns, especially in the context of small and marginal farmers. Innovations are also required for ensuring sustainability and robustness of rural financial institutions.

Keeping in view the overwhelming presence of India in the South Asian Region in terms of geographical size, population and GDP, I propose to encapsulate the initiatives and experiences largely of India. The experiences of two other countries viz. Pakistan and Bangladesh are also duly incorporated.

II. Innovations And Experiments in South Asia

A. India Experience

1. Innovation Strategies

In the backdrop of the foregoing, it is important that the innovations in the rural financial sector have to be multi-pronged and at various levels as under:

i. Policy level - Government and Central Bank
ii. Design and process level
iii. Implementation level
iv. Monitoring level
v. Delivery infrastructure level

i. Policy Level - Government And Central Bank

a. Multi-agency approach

The Government of India has taken several important initiatives in the agriculture and rural financial sectors. They include setting up of Regional Rural Banks in 1975 and NABARD (that I represent today) in 1982. The most recent innovation in this direction has been establishment of specialized banks viz: Small Finance Banks and Payment Banks. These banks have been set up with specific objective of reaching out to the people of small means especially farmers, farm labourers and inland migrants for fulfilling their financial services requirements.

b. Directed priority sector lending

Bank credit has an immense role in the development of the economy. Besides economic growth, it should also lead to removal of poverty and equitable distribution of income. With this objective in mind, Reserve Bank of India, the central bank of the country, conceived the idea of directed lending and implemented through specific targets for priority sector (including agriculture) lending since March 1980. Over last three decades, there have been several changes in the scope of priority sector lending and the targets and sub-targets applicable to various bank groups. The objective of the policy of priority sector lending (PSL) has been to ensure that vulnerable sections of society get access to credit. It also ensures adequate flow of resources to those segments of the economy which have higher employment potential and helps in making an impact on poverty alleviation. Thus, the sectors that impact large sections of the population, the weaker sections and the sectors which are employment-intensive such as agriculture and micro and small enterprises were given high focus under priority sector.

c. Interest subvention and incentive

In order to make agriculture credit affordable to farmers, especially small farmers, the Central Government supports banks with 2% interest subvention. Further, in order to inculcate financial discipline among farmers and timely recovery for the financial institutions, the borrower farmers get another 3% interest relief as an incentive in cases of prompt and timely repayment. Provincial State governments join in and add an extra percent or two for those availing bank loans. These state measures have helped in augmenting agriculture credit in India.

ii. Design and Process

a. Scales of finance

Crop wise per unit area (acre/hectare) credit requirement, known as scale of finance, is fixed at the beginning of the crop season and updated annually so that at branch level interface, credit assessment is done efficiently, scientifically and in a transparent way.

b. Kisan (Farmer's) Credit Card– Annually auto-renewed cash credit

NABARD has come up with a financial product called Kisan Credit Cards (KCC) for easy and hassle free delivery of cash credit to farmers with flexibility in operations. Even groups of small holders (known as joint liability groups) and oral lessees who cannot offer collateral have been made eligible for this line of credit.

Under KCC, enhanced liquidity to farmers is ensured through mandated mark up (30%) to scale of finance. This innovation of mark up to production cost in credit assessment has enhanced liquidity among rural borrowers. Besides, there is provision for 10% annual increment in the loan limit without going through the hassles of sanction procedure. The need and cost for seeking credit from informal sources have fallen substantially due to this mark up to production cost.

The country is in the process of providing these borrowers with digitally enabled RuPay cards so that farmers get better options in use of credit.

c. Issuance and trading of PSL certificates

To ensure efficient implementation of priority sector lending mandate, allow the banks to leverage on their sectoral domain expertise & geographical advantage and to avoid the compulsion of distributing the energy & efforts on every sector/sub-sector under priority sectors, recently a new innovation in the form of Priority Sector Lending Certificate has been introduced in India. Rural banks having exceeded the targeted amount of agricultural and other priority sector loans in their books can issue such certificates at a price to banks which fall short of their agriculture credit targets. These certificates are tradable among banks over an electronic platform. It helps rural banks earn an extra income for their sustainability.

iii. Implementation

a. Subsidy-linked credit schemes

To diversify agriculture and ensure income security to small farmers, Government of India and the Provincial Governments promote subsidy linked credit programmes (dairy, poultry etc.). Subsidised credit linked programmes are also introduced for cold storages, rural godowns, market yards etc. The subsidy under these programmes works as an incentive for farmers to take up these activities and enhances their capacity to borrow from formal banking channels.

b. Area development schemes/plans

To take advantage of specific potential of local natural resources and local human skills, area based banking plans have been prepared for purveying credit to activities allied to agriculture and in off-farm sector. Concessional refinance products have also been created for weak banks predominantly operating in rural areas.

c. Rural Infrastructure Development Fund

Rural infrastructure is an important factor in determining rural credit absorption capacity. The banks in India (with Government as majority shareholder) had been constrained in purveying rural credit due to lack of supporting rural infrastructure and were failing to achieve annual rural credit targets. To address this issue, a major innovation, through creation of a dedicated infrastructure fund namely Rural Infrastructure Development Fund (RIDF), has been brought in since 1995. The amount representing shortfall in achievement of priority sector lending targets is pooled annually from different banks. Provincial governments could borrow from this Infrastructure Development Fund for fast-forwarding rural infrastructure projects. The innovation has been fairly successful in complimenting resources of the provincial governments and completing rural infrastructure projects in time. It has enhanced capacity of the rural poor to borrow and leveraged/allowed the national government in recent years to fix higher rural and agriculture credit targets for banks. India can now boast of having successfully implemented one of the most robust credit supported rural infrastructure programme.

iv. Monitoring

a. Target approach

Being a densely populated area, agriculture is predominantly small holding. Credit to farmers in India is directed by the government. The government sets, in the beginning of the year, the amount of formal sector credit for farming activities and has put in place robust monitoring mechanism. For the current financial year 2016-17, the agricultural credit target is set at Rs. 9 trillion (USD 140 bn).

b. Credit planning

Potential farm activity credit mapping is done annually for each of the sub provinces (Districts) which aggregate into a credit plan for each province (State). Each district (sub-province) is further divided into a few development blocks for the purpose of implementation of various developmental schemes. Dedicated committees are set up at the levels of blocks, districts and provinces. These committees comprise government officials, bankers & peoples' representatives and meet at regular intervals to monitor progress of various government schemes and achievement of rural credit targets. If required, the committees also undertake mid-term course correction initiatives,

v. Delivery Infrastructure

No product or service can be delivered effectively and efficiently without having a robust and strong delivery infrastructure. With objective of purveying credit to millions of farmers and agri-entrepreneurs scattered far and wide, financial, technological, institutional and social infrastructure need to be strengthened. South Asia being a region of small holder farmers' majority, any rural credit innovation approach falls in the following areas.

a. Institutional infrastructure

I) Producers organizations

Innovative institutional infrastructure at farmers' level is required for addressing business reality of small farmers. To this extent India has taken steps to create farmers collectives in the name of Producers Organisations (POs). POs are registered under the local laws and are likely to enhance farmers' bargaining power in inputs and produce markets. As a registered legal entity under the provisions of the law, they can enter into legally valid agreements with financial institutions and banks. The move helps POs in sourcing higher amount of credit and for multiple purposes. They can now collectively join the value chain. The innovation here has been the amendment of the Companies Act which now allows farmers' association (POs) a legal valid entity for execution of agreements. This ensures applicability of contract act and raises lenders confidence.

ii) Crop insurance

In order to managing risks at the farm and household level (especially at a time of climate change), India has recently introduced a new state sponsored Crop Insurance Policy. Using remote sensing and smart phone technology, the new crop insurance policy allows managing variety of risks at localised level and even for a smallholder farm. The scheme is compulsory for farmers availing bank loan and a nominal amount towards premium is deducted at branch level. The coming years will be crucial to assess its success. Farmers' response to the scheme is awaited.

b. Technological infrastructure

The modern communication technology can play an important role in overcoming distance and information bottlenecks. To this effect India has taken big strides, more so after the ban of high denomination currency notes in November 2016.

i) **Biometric identity**

Globally, rural credit suffered due to lack of borrowers' identity and associated credit history. Bio-metrics enabled payment system is being implemented by banks in India under active support from the state. Biometric (AADHAR) cards have been issued to over one billion people of the country. It helps banks addressing identity issues and develops credit history of borrowers.

ii) **National electronic agriculture market**

Using modern communication technology, the state is also creating an e-market platform to connect all major wholesale agriculture markets in the country. This particular step would ensure fair price to farmers from all corners and settlement of bank dues electronically.

c. **Financial infrastructure**

To address the multiple constraints faced by most small farmers, bundling financial services with non-financial services is essential. A few initiatives in this direction are:

i) **Extension services**

India has been following a *Credit Plus* approach. Specialised centres viz. Krishi Vigyan Kendra (Agricultural Science Centre), Agricultural Technology Management Agency (ATMA), Centre of Excellence for vegetables, citrus fruits etc have been created across the country to bring about technological changes in the sector.

ii) **Pradhan Mantri Jan-Dhan Yojana**

In India, there has been a significant state sponsored push to increase usage of financial products by the rural populace. The objective is to provide banking services to a large proportion of unbanked population, mostly rural. The Prime Minister's Jan Dhan Yojana (PMJDY) that includes a savings account, overdraft facilities and insurance benefits, is the largest outreach programme in the world. PMJDY has led banks to cater to the new demand for formal banking credit by previously unbanked borrowers.

iii) **Micro-finance services**

Financial inclusion, micro finance & rural credit are intricately related. India runs the world's largest rural women oriented micro finance programme. The programme, known as Self Help Group Bank Linkage Programme (SHG-BLP), hinges on group approach. SHGs are now a mainstream loaning channel for rural bank branches. So far, more than 7.7 million SHGs have been promoted with an approximate women membership of 100 million and more than 4.4 million of such groups have been credit linked through formal financial institutions in far and remote areas. Besides, digitizing the member data and financial records of these SHGs has been piloted and is now being scaled up. It would help banks in assessing groups' credit absorption capacity, addressing identity issues and avoiding multiple financing.

B. Pakistan Experience

Another major stakeholder of South Asia is Pakistan. Promotion of financial inclusion by developing agri credit market, rural SMEs and microfinance sectors are one of the top priorities at State Bank of Pakistan

(SBP), the central bank. Over the last few years, SBP has taken some ground-breaking initiatives to uplift financing to the farmers and small and medium entrepreneurs:

It has revamped Prudential Banks for Agricultural Financing whereby banks have been advised to formulate all-inclusive agri-finance policies and set up dedicated agri divisions within banks.

The scope of agri-financing has been widened to include value chain financing and Islamic mode of financing.

The per acre credit limits for crops, orchards and forestry, previously set in 2008, have been revised. This was done to meet the enhanced credit requirements of farmers and also increase the agri credit portfolio of banks manifold. Farming community and banks have been overwhelmed by this initiative.

The significance of livestock is well known and it accounts for 55 percent of Pakistan's agriculture GDP. However, the share of credit to livestock is disproportionately small due to high risk perception. Therefore, to address this issue, SBP has introduced a Livestock Insurance Scheme for borrowers to mitigate risk of loss of livestock due to disease, natural calamities & accidents.

To ensure diversity of agri-financing institutions, SBP has included Microfinance Banks and Islamic Banks into indicative targets for agriculture finance.

The Agricultural Credit Advisory Committee (ACAC), which is the apex consultative forum for agri-financing with representation from all the relevant federal & provincial departments, farming community, banks and experts, has been re-activated.

The ACAC set agenda to boost agri financing. This includes launching of the second round of Financial Innovation Challenge Fund (FICF) under the UKAID-sponsored Financial Inclusion Program, to promote innovative techniques in agri and rural financing.

State Bank of Pakistan has launched a country-wide Internship Programme for 100 top graduates in agriculture to be funded under the ADB's Improving Access to Financial Services Endowment Fund.

Banks have been assigned targets for agriculture portfolio outstanding and number of borrowers to have high impact of financing at grass roots level.

SBP has made agricultural finance a key indicator of performance of banks which will be reflected in their supervisory ratings.

A working group of ACAC has been formed to review the state of affairs of small farmers financing and make recommendations for improving financial access to small farmers.

(Source: Welcome address by Mr Ashraf Mahmood Wathra, Acting Governor of the State Bank of Pakistan, at the launching ceremony of the Financial Innovation Challenge Fund)

C. Bangladesh Experience

I shall now turn towards the most densely populated nation of South Asia, i.e. Bangladesh. Bangladesh is one of the most densely populated countries of the world; and mostly rural. Farmers of Bangladesh are generally resource poor. Small and marginal farmers constitute 80 percent of the farming population in Bangladesh. But only 17 percent of the small farmers have direct access to institutional credit. Bangladesh expanded rural credit through NGO route. Bangladesh has been the global pioneer in taking NGO route. In

Bangladesh, formal sector has flourished in recent years in disbursing agricultural credit where previously informal sector dominated. NGOs have a stronger network throughout the country and many local private commercial banks (PCBs) and foreign banks use this channel to provide agricultural credit. Now NGOs are in a significant role in rural economic upliftment by generating growth & creating employment through agricultural credit disbursement. Bangladesh thus created a semi-formal credit sector that includes autonomous credit institutions like the Palli Karma Sahayak Foundation (PKSF), Bangladesh Rural Development Board (BRDB), and numerous NGOs.

Bangladesh Bank, the central bank of Bangladesh, has mandated all local and foreign Private Commercial Banks (PCBs) to invest in agricultural sector. Banks that do not have adequate branches in rural areas were allowed to use linkage with Non-Governmental Organizations (NGOs) for disbursement of agricultural and rural credit. NGOs in Bangladesh have much scope to play role in agricultural credit distribution as they have wider range of branches throughout the country.

Bangladesh Bank made it a policy that processing of application form and sanctioning of credit for the crop loan (up to 5 acres), banks and micro credit organizations disbursing agricultural and rural credit by making partnership with banks will not be able to take any sort of charge documents except DP note, Letter of Hypothecation and Letter of guarantee (Personal).

III. Future Innovations Required

Despite several initiatives and innovations, there are still quite a few issues concerning agricultural and rural credit that are festering. A new array of innovations are required to be directed to tackle these issues. A few of these important issues are elaborated below:

I. The capital formation in agriculture has been showing a declining trend over the years. This is due to overemphasis on food grain crops. Long term investment credit in agriculture is required to address the issue of stagnant productivity and diversification. Since investment credit is the major driver of private sector capital formation in agriculture, the persistent decline in its share raises concern about the agricultural production and productivity.

II. Avoiding grant of loans to farmers beyond their credit absorption capacity.

III. Extension of the coverage of all small/marginal farmers to ensure inclusive growth.

IV. Ensuring of adequacy and timely credit disbursement.

V. Effective monitoring of end use of credit.

VI. Reporting of credit information to credit bureaus for creating credit history of borrowers.

With this narration, I propose to conclude about innovations in rural credit in South Asia. There may be many more innovations in other countries of the region which I might fail to narrate due to absence of seamless cross country exchange.

I thank Bank Indonesia, IFAD and the APRACA for inviting me to this workshop and for giving me opportunity to participate in this discussion session.

I also thank the audience for giving me a patient hearing.

Bankers Institute of Rural Development (BIRD)

Bankers Institute of Rural Development (BIRD), at Lucknow, India, a Society promoted by National Bank for Agriculture and Rural Development, is a premier institute for providing training, research and consultancy services in the field of agriculture and rural development banking in India and the Asia Pacific Region.

ACTIVITIES

BIRD provides training support to supplement Human Resource Development efforts of Banks (Commercial Banks, Cooperative Banks and Regional Rural Banks), Microfinance Institutions (MFIs), Government Departments, Non-Governmental Organisations (NGOs) by organizing training programmes. Based, on specific requirements of the organizations concerned, customized programmes are also conducted by the Institute. BIRD has been conducting training programmes for officers of Indian Administrative Service (IAS), as well as Indian Economic Service (IES).

BIRD offers consultancy services and conducts Applied Research and Studies for gaining insight into the development process of rural banking and related fields for suggesting alternative policy measures. BIRD also participates in collaborative ventures with other training institutes, research organizations within and outside India.

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