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IN BANGLADESH

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II. Recent Performance of Rural Financial Markets
in Bangladesh - Nationalized Commercial Banks

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PERFORMANCE OF RURAL FINANCIAL
MARKETS IN BANGLADESH

— NATIONALISED COMMERCIAL BANKS

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The financial market in the rural economy has two components — institutional and non-institutional. Like in other LDCs, the institutional component in the total rural financial system in Bangladesh is a small fraction. Institutional component of the rural financial market is mainly concerned with agricultural credit, which meets about 15% of the total farm credit needs. The rest 85% or so comes from non-institutional sources. Credit institutions: BKB, BJSB and the NCBs operate more or less in isolation rather than as segments of an integrated financial system.

2. Some of the major problems in rural finance stem from the fragmentation of financial markets. Funds do not flow readily either between markets or even among borrowers within a market. This situation is largely responsible for (1) the lack of competition among lenders, leading to usurious interest rates, (2) an inelastic supply of funds, slowing the investment process when demand for development funds is increasing rapidly, and (3) the use of any surplus funds either for consumption and for land purchase or for other investments that are not related to increasing productivity.

3. Despite the overwhelming importance of the non-institutional component in the rural financial market in Bangladesh, we cannot go deep into that component because of the dearth of adequate and reliable information and statistics. Dearth of information and statistics limits our discussion only to the institutional component of the rural financial market in the country, particularly the nationalised

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commercial banks; the role of the BKB and the BJSB has been dealt with separately.

4. Before the inception of Bangladesh, banking system in this area was urban-oriented and served mainly the needs of the industrial and urban sectors. But since liberation of the country steps have been taken for expansion of banking facilities both in the urban and rural areas to mobilize the untapped idle savings as well as to develop banking habits amongst the masses and to extend banking services to all areas and classes of people. With these objectives in view a deliberate policy has been pursued to cover all the unbanked business centres and important places of Bangladesh with, at least, one branch of a nationalised bank, as quickly as possible. The branch expansion of all NCBs and BKB taken together has indeed been remarkable from 1,148 in December, 1971 to 2,742 in June, 1978 - a rise of 139 per cent.

5. The number of rural bank branches increased by 285% from 414 in June, 1972 to 1,594 in June, 1978. The rate of bank branch expansion in the rural areas has been phenomenal in recent years, and as many as 496 rural branches were opened during FY 1977-78. Thus the rural branches constituted over 58% of the total branch network in June, 1978 as against 36% in June, 1972.

6. In respect of the overall volume of operations the rural branches were yet far behind the urban branches. Although the former comprised 58% of the total bank branches, they accounted for only about 14% of the total deposits and about 7% of the total advances. Of late a rising trend has been noticeable as shown in the following Table:

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PERCENTAGE DISTRIBUTION OF ADVANCES, DEPOSITS
AND BANK BRANCHES BY AREA (URBAN AND RURAL)

As on/ Area	31-12-1976		31-12-1977		30-6-1978	
	Urban	Rural	Urban	Rural	Urban	Rural
Advances	96.53	3.47	95.50	4.50	93.50	6.50
Deposits	90.21	9.79	89.67	10.33	86.22	13.78
Branches	49.31	50.69	41.96	58.04	41.87	58.13

The above table shows a faster growth of rural branches, deposits and advances. The progressive rise in the share of rural advances and deposits resulted from the all-out emphasis of the Government and the drive of the banks to finance agricultural and non-agricultural activities in the rural areas and to develop banking habits amongst the rural masses.

7. One important objective of state ownership of the financial institutions has been to improve credit allocation not only among different sectors but also between different classes. A major concern of the Government has thus been to increase the availability of institutional credit to the rural areas to raise crop production in particular, and to increase the level of overall economic activity since the bulk of the country's population (92%) live in the rural areas. With renewed emphasis on rural development it is expected that operations of the banks would be so directed as to significantly reverse the past trend of net outflow of funds from the rural to the urban areas of the country in the interest of balanced development.

8. It is untenable that the rural sector which produces about 80% of the GDP should have 14% of the total bank deposits and 7% of bank advances. Although the share of bank advances to rural areas improved from 3.32% at the end of 1975 and 3.47% at the end of 1976 to 4.50% at the end of

● All municipal areas are treated as urban areas.

1977 and further to 6.50% at the end of June, 1978, the net difference between the percentage distribution of deposits and advances by urban and rural areas remained more or less the same (i.e., about 6%) as shown below :

PERCENTAGE DISTRIBUTION OF ADVANCES AND DEPOSITS BY AREA (URBAN AND RURAL)

As on	31-12-75		31-12-76		31-12-77		30-6-78	
	Urban	Rural	Urban	Rural	Urban	Rural	Urban	Rural
Deposits	90.51	9.49	90.21	9.79	89.67	10.33	86.22	13.78
Advances	96.68	3.32	96.53	3.47	95.50	4.50	93.50	6.50
Net Difference	+ 6.17	-6.17	+6.32	-6.32	+5.83	-5.83	+ 7.28	-7.28

The net difference between deposits and advances in the rural areas roughly measures the extent of transfer of capital from the rural to the urban areas. The apparent conclusion is that the rural areas are being exploited through intermediation of the banking system contrary to the objective of expansion of rural bank branch network.

9. The desirability, possibilities and problems of agricultural financing by commercial banks were thoroughly discussed in a "Seminar on Agricultural Financing" sponsored by the Bangladesh Bank in February, 1973. The seminar was of the view that the commercial banks in Bangladesh could and should play a useful role in the provision of agricultural finance in the country by expanding their network of branches in rural areas, and that the use of commercial banks will also reduce demand on central bank resources, which is inflationary in character, for agricultural financing, as long as there was surplus fund in the banking system. Before 1974, the NCBs were engaged mainly in industrial and commercial financing. But since 1974 the NCBs have steadily extended their resources for rural financing, although in physical

terms these were yet far short of the total finance required.

10. As for the main problems that stand in the way of any substantial boost in institutional agricultural credit, the NCBs do not yet have the staff or union level facilities that will be required if their loans to the farmers/small men are to be adequately supervised and evaluated. Without proper provision for evaluation and supervision, collection of the loans being extended may be difficult and use of the loans for agricultural production cannot also be ensured. Neither the NCBs nor the Bangladesh Krishi Bank (BKB) is adequately strong in terms of staff or facilities to service the short-term credit needs of farmers at union level as assigned to them under the official programme of the Government /Bangladesh Bank. In particular, the NCBs have only limited experience in direct lending to ordinary small farmers in Bangladesh, as mentioned earlier. Efforts are being made to recruit and train additional staff.

11. The performance of the NCBs in the field of small loans was insignificant before mid-1975. As the small man could not always offer tangible/acceptable security, his needs were often overlooked and ignored. In fact, it was observed that some banks warded off small borrowers on one ground or the other. The need for concerted effort to support the small men was thus felt by the policy-makers. In July, 1975, Bangladesh Bank decided that every nationalised commercial bank should have a target of Tk.1 crore for small advances during July-December, 1975, the average size of the loan should be around Tk.10,000 and such loans should be made to the small traders and shopkeepers.

12. The endeavour of the banking system to support the weaker sections of the society and various self-employed persons to carry on or expand their trade or profession were

© 1 Crore = 10 Million.

consolidated under the Small Loans Scheme incorporated in the Bank's Credit Policy for the year 1976-77. Targets for each NCB for that year were fixed at 1% of their total deposit liabilities to be disbursed as small loans. The categories of persons eligible for such small loans were as follows :-

- | <u>1. Cottage Industries</u> | <u>Area</u> |
|--|---|
| a) Weaving | Rural & Semi-rural areas |
| b) Handicrafts | -do- |
| c) Cane & Bamboo works | -do- |
| d) Carpentry | -do- |
| e) Pottery | -do- |
| f) Brass Metal Industries | -do- |
| g) Other rural industries | -do- |
| <u>2. Retail Trade (i.e., small Shopkeepers) in stationery, groceries, cloth, medicine, handicrafts, books, confectionery, spare parts, tyre/tube etc.</u> | Urban, semi-urban and rural areas (excluding city area) |
| <u>3. Other self-employed persons, viz.</u> | |
| a) Engineers | Urban & semi-urban |
| b) Doctors | Semi-Urban & Rural |
| c) Tailors | Urban & Semi-Urban |
| d) Fishermen | Rural |
| e) Blacksmiths | Urban & Semi-urban |
| f) Rickshaw pullers | -do- -do- |
| g) Taxi/Auto rickshaw drivers | Urban |

The maximum limit of small loans was Tk.25,000 per party for trade and business and Tk.50,000 per party in the small-scale industrial sector, including cottage industries.

13. One of the objectives of the "Lead Bank Scheme" since introduced in the districts is also to identify the self-employed persons and various other weaker sections of the community and to assess their credit needs and potentiality

with a view to extending the required credit support in collaboration with the other NCBs. Some caution has, however, to be exercised regarding the selection of areas and persons eligible for small loans. Banks have to be on guard that retail-traders in the cities and towns with comfortable stock position do not use funds extended to them for purposes other than those for which these are intended. Caution is also necessary with regard to new entrants in manufacturing who might lack the entrepreneurial ability or knowledge of market conditions. For these reasons, it is necessary that small loans scheme in a region be linked with the overall development schemes of that region. Generally, it can be said that the small loans scheme is a viable one. Since it is production-oriented, there is more possibility of credit absorption in productive channels and lesser scope for inflationary generation. At the same time, it can go a long way in ameliorating the economic condition of the common man.

14. The small loan target of each of the nationalised commercial banks during the year 1977-78 was revised upward to 2 per cent of their deposit liabilities to be disbursed in two phases as against 1½ per cent ^{fixed} for the preceding year. In view of the rising price structure, the maximum limit for small loans was also increased from Tk.25,000 to Tk.50,000 per party for trade and business and from Tk.50,000 to Tk.100,000 per party for small and cottage industries. In addition, the usual security requirements were relaxed in favour of proven skill of the borrower, his sense of honesty and integrity as well as the prospect of his business. In order to further expand the scope of the Small Loans Scheme a special credit programme of Tk.6 crores* was launched for cottage and small scale industries from 1st February, 1978.

* 1 Crore = 10 Million.

Under the programme, a Committee has been set up in each district, headed by the Deputy Commissioner or Additional Deputy Commissioner (Dev.) of the district, and the financing bank sanctions and disburses loans on the basis of concrete recommendations of the District Committee as to the amount and period of the loan.

15. Further, in view of the need to plough back the resources tapped from the rural areas and the importance attached to the development of the rural economy, banks were advised to increase the flow of credit to the rural/under-developed areas urgently and to aim at increasing the credit/deposit ratio in the rural areas upto 40 per cent by the end of 1977-78. Banks' efforts in this direction met with considerable success. This will be evident from the fact that 46 per cent of the deposits mobilised in rural areas as on 31st December, 1977 was deployed in rural areas against the ratio of 28 per cent as on 31st December, 1976.

16. Considerable emphasis was also placed on mobilising deposits in the rural sector. Prospects for mobilizing deposits in this sector brightened up because of four important developments. First, consecutive three good crops of rice in the country, coupled with higher prices of jute in the primary market during 1977-78 improved the cash position of the surplus farmers in the rural sector. Second, generally higher prices of farm products, namely, beef cattle, poultry, milk, eggs, onion, chillies, pulses etc. increased the income of the farmers. Third, the operation of Tk.100 crore Special Agricultural Credit Programme resulted in increased flow of funds to the rural areas. Fourth, increased emphasis on rural development resulted in sizeable developmental outlay in the rural areas. In order to mop up the surplus funds with the farmers, interest on fixed deposits for 6 months to 1 year

and from 1 year

/to 2 years is being paid at 1 per cent higher than the normal rates on deposit accounts opened by individuals in rural areas after 15th December, 1977. Total deposits collected on the enhanced interest rates amounted to more than Tk.2 crores by the end of June, 1978. The deposit mobilisation efforts in the rural areas were also sought to be helped by opening a large number of branches in these areas. During the year scheduled banks opened as many as 691 branches in the country out of which 496 were opened in rural areas. The number of rural branches thus stood at 1,594 in June, 1978 out of a total net-work of 2,756.

17. A Special Agricultural Credit Programme of Tk.100.00 crores, in addition to the normal annual agricultural credit programme in which the NCBs participate, was launched for the calendar year 1977 from February, 1977 in keeping with the Government's growth strategy to give priority to rural agricultural development. The total disbursement under the programme amounted to Tk.60.68 crores till the end of December, 1977. This special programme has been renewed from January, 1978 and the target amount increased to Tk.150.00 crores to be disbursed within June, 1979. The recovery performance under the programme has not, however, been very satisfactory so far. Out of the total disbursement till December, 1977, the amount recovered upto June, 1978 was Tk.28.11 crores only, representing 46.32% of the total disbursement.

18. In order that the special farm credit programme does not interfere with sound monetary management, it is of crucial importance that the loans extended under the programme are utilised for productive purposes and the repayment schedules prescribed by the banks are strictly adhered to by the borrowers. Needless to emphasize, it will be difficult for the banks to continue this programme unless the borrowers

observe adequate repayment discipline. Measures have already been taken to improve the repayment performance. The Government have extended to the commercial banks the benefit of the Public Demands Recovery Act to enable the banks to recover their agricultural loans as arrears of land revenue. Banks have also appointed special recovery assistants in their rural branches to pursue the borrowers for recovery of the overdue loans. It has also been impressed on the Chairmen and Members of the Union Parishads to extend their full assistance to the banks to improve the recovery performance.

19. For achieving a break-through in the rural economy, it is necessary to provide credit not only for crop production but also for non-farm activities in order to generate additional sources of employment and income for the rural people, particularly the landless farmers and share-croppers. With this objective in view, a special credit programme of Tk.6.00 crores, as mentioned earlier, was launched for cottage and small industries from 1st February, 1978. An allocation of Tk.3.00 crores was also made under Tk.100.00 crore Special Agricultural Credit Programme for development of pond fisheries. In addition, banks are providing finance for purchase of rickshaws, as also for purchase of dhakis (an indigenous instrument for paddy husking), for cow and goat fattening, etc.

20. Though the disbursements made so far under the various schemes mentioned above are of modest amounts, there is no doubt that a good beginning has been made. In the ultimate analysis, the success of such non-farm lending will depend on, among other things, careful selection of borrowers with an eye on their technical expertise and sense of honesty and integrity, adequate motivation and orientation among the bank officials to break into new areas of lending for productive purpose, close supervision on the use of loans and strict enforcement of repayment discipline.

21. Meanwhile, starting with a modest amount of Tk.8.81 crores only in 1974-75, agricultural credit disbursements by the NCBs increased by 134% to Tk.88.62 crores in 1977-78 from Tk.37.81 crores in the previous year. Incidentally, it may be mentioned that total disbursements of institutional agricultural credit by all the agencies including B.J.S.B. and B.K.B. amounted to Tk.160.80 crores in 1977-78 against Tk.87.94 crores in 1976-77, indicating a rise of 83% over the year. The comparative performance of the NCBs since 1974-75 is shown below :-

Year	Amounts Disbursed in crore Taka	Percentage increase.
1974-75	8.81	-
1975-76	20.61	+134%
1976-77	37.81	+ 83%
1977-78	88.62	+134%

Thus in the latest year (1977-78) the NCBs provided as much as 55% of the total institutional agricultural credit as against 25% in 1974-75.