

**THE CONTRIBUTION OF THE  
REGIONAL RURAL  
DEVELOPMENT BANKS  
IN THE  
UPLIFTMENT OF THE  
RURAL ECONOMY**

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**SRI LANKA ECONOMIC ASSOCIATION**

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This paper is one of the 18 papers, published under a special series of publications by the Sri Lanka Economic Association (SLEA) with financial assistance from the United States Agency for International Development (USAID). The objective of these publications is to provide economic literature on current and topical themes on the economy of Sri Lanka to a broad audience that is interested in economic issues, but has little or no background in theoretical economics, while maintaining high analytical standards. Hence, the papers have been written in simple language avoiding the use of sophisticated technical terms, mathematical equations and models etc. which are normally found in economic literature.

# THE CONTRIBUTION OF THE REGIONAL RURAL DEVELOPMENT BANKS IN THE UPLIFTMENT OF THE RURAL ECONOMY

## THE RURAL ECONOMY - WHAT IS ITS IMPORTANCE FOR SRI LANKA?

Sri Lanka is predominantly a rural economy. Rural economies in less developed countries such as Sri Lanka are characterised by the twin problems of poverty and unemployment. In order to reduce poverty in a rural economy such as ours several challenges have to be met. The most fundamental need in this regard is to see that a definite part of institutional credit is diverted to the rural poor. Sectoral growth performance has consistently proved that the agricultural sector, where the rural poor predominate, either records poor growth or no growth at all. Thus, a programme for rural development must ensure a definite flow of credit to the rural sector and the right of access to the villagers to credit from formal financial institutions. The main focus of rural development should be to combat the twin problems of poverty and unemployment in the rural areas where almost 80 per cent of Sri Lanka's population live. To be successful in this regard and to achieve the ultimate objective of rural development through the eradication of

poverty and the creation of more employment, rural lending has to be made viable and community oriented.

The paucity of credit to the major part of the population engaged in agricultural and agriculture-related activities by institutional lenders, has driven the rural poor into the clutches of the indigenous money lenders. This has forced Government intervention to encourage more lending to this sector through the establishment of specialized institutions and national schemes. These measures are primarily aimed at providing credit at subsidised rates of interest, thereby making credit affordable in the rural areas. Despite many efforts made by the policy makers, institutional credit (i.e. by commercial banks) to the agricultural sector has remained low. For instance, their share of agricultural credit as at the end of the third quarter in 1992 had declined to 10.8 per cent of total institutional credit from 13.5 per cent in December, 1991. This is in sharp contrast to commercial and industrial credit which aggregated 44.0 per cent and 17.5 per cent respectively. The insufficient flow of credit has thus adversely affected the use of proper cultural practices and the application of agricultural technology through various inputs which would, in turn, ensure maximum yields. There thus exists a yawning gap between the average yield per hectare of agricultural land and its potential yield.

The root problem which confronts us is, therefore, the ever-widening gap between the formal banking sector and the rural sector. On the one hand the evidence of considerable

sophistication - Automated Teller Machines (ATMs), computerization - and, on the other, evidence of the most basic developing economy - very few rural people who constitute 80 per cent of the population, have bank accounts. Therefore, how do we bridge this gap? - to bank the unbanked is a challenge facing the policy makers. New products and approaches are required. There is a need for the banks to realise that what they offer must be more closely tailored to the actual needs of a developing country. It is access to credit that is more of a problem than the cost of it. A concerted effort has therefore got to be made to make banking sustainable in the rural sector. This would ensure an adequate flow of credit to development-oriented activities in the rural sector, which would be employment generating and which, in turn, would ensure higher income levels, thus helping to make banking more attractive in this sector.

The rural sector is, by and large, considered not bankable by the banking industry in Sri Lanka, not because there is a shortage of bankable projects but, because of the demand by institutional sources of credit, for bankable security which seriously inhibits the grant of credit even to highly bankable projects. The poor monitoring of the end-use of funds disbursed to this sector and the resultant high incidence of default experienced by the State banks in this sector points to a general lack of motivation of bank officers involved in rural banking. Managers of commercial bank branches in the rural areas are, in most cases, not equipped to assess rural credit entirely on its

viability which would, in turn, ensure the efficient servicing of debt. Instead, the insistence by them on acceptable security from the rural poor results in the applications for credit very often being declined for this reason. Rural credit by its very nature, and in consideration of the clientele it caters to, has to be judged on the merits of the project which the loan is expected to finance. To base the decision to grant the credit on the merits of the collateral cover, is to assume at the very outset that the project is not bankable and that it should, therefore, be adequately insured against default. The failure of institutional credit to the rural sector can, therefore, be attributed, basically, to the attitudinal approach of banking institutions to their rural clients.

### **RURAL BANKING - HOW HAS IT ASSISTED THE RURAL ECONOMY?**

The inherent risks associated with rural credit has meant that the rural sector has remained severely underbanked and even the State banks have had to be induced or lured into this sector by way of credit support. Credit disbursed in the rural sector, as a percentage of deposits mobilised by the banks in this sector, is very low. This results in poor credit/deposit ratios displayed by the banks in the rural sector, where branches established by the indigenous commercial banks, very often function more as deposit mobilising centres than as lending institutions. This amply illustrates the basic objective of the banks in this sector as one of deposit mobilising. These deposits are in turn channeled into the City of Colombo to serve an already over-fed urban clientele.

Whatever credit is disbursed in the rural areas has been through governmental intervention by way of development loan schemes which the banks have had, perforce, to administer on behalf of the Government. Furthermore, for most of these schemes the Central Bank has made available funds to the commercial banks in the rural areas, for the purpose of lending in these areas, at concessional rates of interest which is commonly known as refinance. This trend is amply illustrated by the fact that whilst total savings mobilized in the rural sector by the People's Bank through the Co-operative Rural Banks (CRBs), the Bank of Ceylon through its ASC branches, the Regional Rural Development Banks (RRDBs) and the Thrift and Credit Co-operative Societies (TCCSs) increased by 27.4 per cent at end 1992 over figures at end 1991, total loans granted to this sector by these institutions increased by only 7.5 per cent. This resulted in a credit/deposit ratio of 0.41 at end 1991 for this sector declining to 0.35 at end 1992. It is always the case, therefore, that the increase in deposits mobilized in the rural sector is never matched by a commensurate increase in credit disbursed to this sector. In the normal course of banking business, this trend could have been ignored. However, because of the desperate need for credit in the rural sector there is an urgent need for the effective deployment, within the rural sector, of resources mobilized from this sector, at least for the benefit of the rural poor. Although legislation exists for enforcing such a requirement on the banks, the dilemma faced by the authorities is that, with the foreign

banks being concentrated in Colombo, and only the indigenous banks being represented in the rural areas, these requirements cannot be uniformly implemented.

The flow of credit into the rural sector in 1992 was primarily under the New Comprehensive Rural Credit Scheme (NCRCS) and the Medium and Long Term Credit Fund (MLCF), the Kirindioya Irrigation and Settlement Project, the Perennial Crop Development Project, the Small Holder Tea Development Project and the Agriculture Rehabilitation Project. The enhanced credit disbursements under these schemes were mainly due to the refinance facilities provided by the Central Bank of Sri Lanka. Although refinance under the MLCF was suspended temporarily a limited amount was made available to the RRDBs for small-scale employment projects. Of significance here is that 50 per cent of the losses suffered by banks on loans granted under the NCRCS were indemnified by the Central Bank. In this context it is relevant that whilst 44 per cent of total advances disbursed by the commercial banks were for trading activities, registering an increase of 24 per cent over the previous year, credit granted for agricultural purposes declined from 13.5 per cent in 1991 to 10.8 per cent in 1992.

Table I illustrates that rural banking is, perforce, concentrated in, and has become the burden of, four types of institutions which mobilize rural savings and disburse rural credit. They are the RRDBs, the People's Bank through its CRBs, the TCCSs and, to a limited extent, the Bank

**TABLE I**  
**DEPOSITS AND ADVANCES TO THE RURAL SECTOR**

	Co-operative Rural Banks (CRBS)		Bank of Ceylon sub-offices at Agrarian Services Centres (ASCS)		Regional Rural Development Banks (RRDBs)		Thrift and Credit Co-operative Societies (TCCSs)	
	1991	1992	1991	1992	1991	1992	1991	1992
1. Total Savings	3,448,488	4,333,051	220,120	287,255	437,533	666,561	588,012	696,829
1.1 Savings	3,133,556	2,930,578	181,219	222,747	387,806	586,943	469,570	553,437
1.2 Special Savings	-	-	12,434	21,590	-	-	78,264	90,458
1.3 Fixed Deposits	314,932	402,473	26,467	42,917	49,727	79,618	40,178	52,934
2. Total loans granted	583,730	595,579	208,822	134,216	595,399	703,235	608,601	715,120
2.1 Agriculture	64,489	77,769	n.a.	50,793	340,615	321,054	175,123	188,465
2.2 Animal Husbandry	45,946	38,764	n.a.	1,105	24,336	32,800	64,026	45,972
2.3 Fisheries	-	-	-	6	7,967	12,925	-	-
2.4 Small Industries	39,310	34,916	n.a.	1,178	58,987	81,517	92,937	91,986
2.5 Housing, Electrification and water supply	236,920	256,360	n.a.	6,243	-	-	152,753	249,210
2.6 Projects / Commerce	111,055	102,551	n.a.	49,638	80,010	113,023	62,482	34,326
2.7 Others	86,010	85,219	n.a.	25,250	83,484	141,916	61,280	105,161

Source: Annual Report of Central Bank of Sri Lanka - 1992

of Ceylon's sub-offices at the ASC branches. A comparative analysis of the rural banking performance of these institutions indicates that, whilst the CRBs mobilized 72.4 per cent of total rural savings as at end 1992, they disbursed only 27.7 per cent of total rural credit. However, the RRDBs and the TCCSs which mobilized 11.1 per cent and 11.6 per cent of rural savings, respectively, disbursed 32.7 per cent and 33.3 per cent of rural credit respectively. Whilst RRDBs predominate in agricultural lending with 50.3 per cent of total credit disbursed for agriculture, the CRBs, and the TCCSs had 50 per cent each of total credit disbursed for housing.

### **Co-operative Rural Banks (CRBs)**

The CRBs, which form the rural banking arm of the People's Bank, are directly linked to the Multi-purpose Co-operative Societies under which they operate. They mobilize rural savings through savings and fixed deposit accounts and provide credit facilities to the rural sector primarily for non-productive purposes. They are not commercial banks as they do not accept demand deposits and do not provide withdrawals by cheque. The primary objective of the CRBs was the provision of institutional banking facilities to the rural poor who hitherto had had no access to institutional sources. The network of CRB branches which, as rural banks, stood at 90 in 1970, had expanded to 1094 at end December, 1992. Total deposits mobilized by them which were Rs. 541.5 million at end 1982 have grown by 781 per cent

in the last decade to Rs. 4.8 billion at end December, 1992 and accounted for 0.96 per cent of total deposits of the financial sector. Average deposits per branch which were Rs. 0.67 million rose to Rs. 4.37 million during the same period and registered an average balance per account of Rs. 1,400. Total advances too showed a commensurate increase in the last decade. A credit/deposit ratio of 0.56, however, indicates that there is a significant outflow of resources from the rural areas, via the CRBs, to the People's Bank Head Office in the City of Colombo. Of total credit granted by the CRBs, only 13.6 per cent has been for agriculture whilst 39.4 per cent has been for housing. CRB advances are characterized by a high percentage of default - 11.3 per cent - of which 40.4 per cent are agricultural advances. It can be concluded therefore that the CRBs are an effective mechanism for the mobilization of rural savings. However, as lenders to the rural sector their performance is inadequate from the point of view of the development of the rural economy. The high degree of default experienced by the CRBs in their lending activity may be attributed to the lack of motivation of the staff and to the availability of more attractive and less risky investments for the resources mobilized.

### **Thrift & Credit Co-operative Societies (TCCSs)**

The TCCSs, which have been in existence since the beginning of this century, have a common objective with the CRBs to provide credit facilities and mobilise funds from the rural sector. Although their lending is restricted to members of the TCCSs,

they mobilise savings even from non-members. They are the link between the rural public and the government and have been an efficient means through which non-governmental organisations (NGOs) and other external agencies have channelled development resources at village level. National credit programmes too are channelled through the TCCSs. The high growth rates recorded by them of total savings and total loans are an indication of how effective a mechanism they are in meeting the banking needs of the low income groups to which they cater predominantly. Whilst total savings grew by 18.5 per cent to Rs. 696.8 million in 1992 from Rs. 588.0 million in 1991, total loans grew by 17.5 per cent from Rs. 608.6 million in 1991 to Rs. 715.1 million in 1992.

The lack of participation of the commercial banking sector - of the private indigenous commercial banks per se - has been due to the lack of a rural orientation in their general credit policy. Whatever rural credit is disbursed by this sector has become the burden entirely of the two State banks which have, perforce, had to administer the government's development loan schemes for this sector. Even in the case of the State banks the efficiency of branch managers is judged by branch profits which, in itself, pre-empts the high risk area of rural agricultural credit at rates of interest which do not reflect the risks entailed. Branch managers in rural locations are thus content to make their branches almost entirely deposit-mobilizing offices with interest earned on funds with Head Office accounting for a major part of the income of

the branch. The only credit disbursed by these branches is very often to members of the staff of the branch which, like Head Office funds, is a low-yield activity. The current trend by some of the indigenous banks to expense provision for non-performing loans at branch level also acts as a deterrent to rural lending, the high risk nature of which entails, in the absence of realisable collateral against these advances, the maintenance of provision against them which is a charge on the profits of the branch and which would result in the branch being less profitable or loss-making.

Sri Lanka, being essentially an agricultural economy, the Government has naturally had an abiding interest in ensuring that an adequate and steady flow of credit is diverted to the agricultural, rural sector. In the absence of a definite commitment by the commercial banks to this sector and, in view of the difficulty involved in compelling the banks to lend adequately to this sector, the Central Bank had to find ways and means of achieving its primary objective of promoting and maintaining a high level of production, employment and real income and of encouraging and promoting the full development of the productive resources of Sri Lanka. It was this consciousness that economic growth must be matched by a commensurate growth in rural incomes and should be reflected in the general upliftment of the rural economy, that prompted the strategic development of the RRDBs in 1985.

The Central Bank has, therefore, had to step in to fill the void that hitherto existed in institutional credit to the rural sector which is the back-bone

of any agricultural economy and an area in which commercial bankers fear to tread. The Central Bank's intervention has been influenced by the difficulty experienced by rural borrowers in obtaining credit and by the desire to mitigate the crippling effect of indigenous money lenders on the rural populace who have had, perforce, to resort to this source of credit, not necessarily for development activity, but just to eke out a daily living.

### **RRDBS - A NEW CONCEPT OF BANKING IN SRI LANKA**

The RRDB Act No. 15 of 1985, which established the RRDBs, was enacted, primarily and essentially, for the purpose of providing funds for the development of economic activity in the rural sector of Sri Lanka.

The Monetary Board of the Central Bank is thus empowered to establish RRDBs in selected districts to achieve their primary objective which is to promote agriculture and encourage rural development. Four RRDBs were established in the second half of 1985 in the districts of Kalutara, Matara, Kurunegala and Anuradhapura; one was established in 1986 in the district of Hambantota and another in Kegalle in 1987. The setting up of the RRDBs was thus a hallmark in the Central Bank's strategy on rural credit.

The RRDBs which, today are represented in 17 districts with 156 branches, have 11.1 per cent of total deposits in the rural sector (comprising the CRBs, the ASC branches of the BOC and the TCCSs) and 0.3 per cent of the deposits of the entire financial system.

Although the CRBs have the largest share of rural deposits - 72.4 per cent - the RRDBs and the TCCSs have the largest share of rural credit. The RRDBs, however, remain the largest lenders to the agricultural sector - 50.3 per cent of total agricultural credit. In taking institutional credit to the doorstep of the rural poor, the RRDBs have recorded a 26 per cent increase in the number of branches as at end 1992 and have joined the commercial banks in providing mobile banking services in remote unbanked areas. The rapid expansion of the RRDBs into the remotest rural areas has resulted in an increase of 52 per cent in the value of their total deposits over 1991 and in an increase of 35 per cent in the number of deposit accounts held by the RRDBs over 1991. The average savings account balance which was Rs. 920 in 1991 increased by 12 per cent to Rs. 1,030 in 1992 and the average fixed deposit account balance increased by 25 per cent from Rs. 18,929 in 1991 to Rs. 23,661 in 1992.

In the disbursement of rural credit the RRDBs recorded a growth of 18.1 per cent from Rs. 595 million in 1991 to Rs. 703 million in 1992. Although they lend largely for agriculture, viz: 40 per cent of total loans in 1992, the share of agricultural loans has gradually recorded a declining trend from 52 per cent in 1990 to 40 per cent in 1992, the slack being taken up by loans granted for small industries, commerce and business which increased from 23 per cent of total loans in 1991 to 28 per cent in 1992. Loans granted under the Pawning Loan Scheme which are, primarily, for unproductive purposes, however, recorded a significant increase of 96 per cent over the previous year.

**Table 2**  
**BRANCH EXPANSION OF RRDBS**

Name of the RRDB	Date of Establishment of the RRDB	Number of branches opened								Total at the end 1992
		1985	1986	1987	1988	1989	1990	1991	1992	
1. Kalutara	85.07.13	4	3	4	1	-	-	1	2	15
2. Matara	85.07.28	5	2	-	1	-	-	-	4	12
3. Kurunegala	85.08.10	6	4	2	1	1	1	-	2	17
4. Anuradhapura	85.08.12	2	4	1	-	-	-	3	1	11
5. Hambantota	86.12.13		2	2	2	-	1	-	1	8
6. Kegalle	87.02.08			8	1	2	-1+1	-	1	12
7. Puttalam	87.07.11			5	1	-	2	1	1	10
8. Galle	87.08.17			1	7	1	-	-	3	12
9. Mahanuwara	87.10.03			6	3	-	1	1	2	13
10. Nuwara Eliya	88.10.10				1	3	2	-	2	8
11. Moneragala	88.10.11				1	2	1	2	-	6
12. Badulla	90.10.13						4	2	3	9
13. Polonnaruwa	91.05.17							4	2	6
14. Matale	91.06.21							5	1	6
15. Ratnapura	91.09.30							4	2	6
16. Ampara	92.02.24								5	5
<b>TOTAL</b>		<b>17</b>	<b>15</b>	<b>29</b>	<b>19</b>	<b>9</b>	<b>12</b>	<b>23</b>	<b>32</b>	<b>156</b>

Source: Annual Report of Central Bank of Sri Lanka - 1992

An appreciable expansion of its branch network has taken place since RRDBs were first established in 1985 with 17 branches. Its branch network has grown since then at an average rate of 40.4 per cent every year. In achieving their primary objective of taking banking and, in particular, rural credit, to the remote, unbanked areas of the rural sector, the RRDBs ensure that their branches reach out to sections of the rural population who have absolutely no access to banks or other formal institutional sources. It is significant in this regard that the Matara RRDB, which was one of the first to be set up in 1985, located all its 5 branches in totally unbanked areas. Even the Bank's head offices are expected to be located in the heart of the rural community and not at its district head quarters. This is an efficient means of ensuring that the banks do not drift away from their rural base and from the on-site involvement in rural development at grass-roots level. This is important in ensuring that they achieve their primary objective of the development of the rural credit process. It was in this regard that in 1984, the year before the RRDBs were established, it was found that total commercial bank lending to the agricultural sector was hardly 10 per cent of lending by the banking industry. This situation has not changed very much today with agricultural lending by the commercial banks representing only 10.8 per cent of total commercial bank credit even in 1992 (as at end of the 3rd quarter) with no prospects of an improvement in this regard by the commercial banks even in the future.

**Table 3**  
**POPULATION PER BANKING OFFICE AS AT 30. 06. 1993**

District	Population	NUMBER OF BRANCHES		Total No. of Banks	Population per Bank
		Commercial Banks	R.R.D.Bs		
1. Ampara	474,000	14	06	20	23,700
2. Anuradhapura	705,000	30	11	41	17,195
3. Badulla	701,000	32	09	41	17,097
4. Baticaloa	409,000	12	-	12	34,083
5. Colombo	1,935,000	186	-	186	10,403
6. Galle	932,000	34	12	46	20,261
7. Gampaha	1,518,000	61	01	62	24,484
8. Hambantota	510,000	20	08	28	18,214
9. Jaffna	863,000	22	-	22	39,227
10. Kalutara	934,000	33	15	48	19,458
11. Kandy	1,236,000	45	13	58	21,310
12. Kegalle	743,000	29	12	41	18,121
13. Kilinochchi	99,000	03	-	03	33,000
14. Kurunegala	1,410,000	43	17	60	23,500
15. Mannar	129,000	03	-	03	43,000
16. Matale	414,000	16	06	22	18,818
17. Matara	765,000	31	12	43	17,791
18. Moneragala	344,000	13	06	19	18,105
19. Mullaitivu	91,000	04	-	04	22,750
20. Nuwara-Eliya	530,000	25	08	33	16,060
21. Polonnaruwa	314,000	20	07	27	11,630
22. Puttalam	589,000	23	10	33	17,848
23. Ratnapura	923,000	34	06	40	23,075
24. Trincomalee	311,000	10	-	10	31,100
25. Vavuniya	114,000	03	-	03	38,000
<b>T o t a l</b>	<b>16,993,000</b>	<b>746</b>	<b>159</b>	<b>905</b>	<b>18,776</b>

Source: Computed from the data published by the Central Bank

Note: The CRBs and the TCCSs have been excluded from the above computation as they do not constitute full-fledged commercial banks.

## **IS SRI LANKA ADEQUATELY BANK?**

The total number of commercial bank branches in Sri Lanka as at 30.06.93 stands at 746 with a population per branch of 22,779. The population per branch office as at this date including the 159 RRDB branches stands at 18,776; The total number of branch offices (inclusive of the CRB offices) therefore stood at 2009 as at 30.6.93 with a population per banking office of 8,458. Table 3 illustrates that whilst the commercial banks predominate in the commercial city centres eg. Colombo 186, Gampaha - 61, Kandy - 45 and Kurunegala - 43, with banking density per commercial bank office being lowest in the City of Colombo, viz: 10,403, the RRDBs predominate in the rural areas such as Anuradhapura - 11, Kalutara - 15, Kegalle - 12, Puttalam - 10. Of the 13 branches situated in Kandy, 10 are in intensely rural areas. The largest number of RRDB branches are in Kurunegala - 17 - the rural hinterland of Sri Lanka. Density per RRDB banking office is lowest in Polonnaruwa at 11,630. It is significant that there are no RRDB branches in Colombo and only one RRDB office in Gampaha, both of which have the largest number of commercial bank branches. viz: 186 and 61, respectively. Apart from Colombo, the RRDBs are still not established in the Northern and Eastern parts of Sri Lanka, ie. in Batticaloa and Trincomalee in the East and in Jaffna, Kilinochchi, Mannar, Mullaitivu and Vavuniya in the North, for obvious reasons.

In the location of their branch offices in the remotest rural areas of Sri Lanka, therefore, the RRDBs have preserved their agrarian orientation and achieved their primary objective of serving the rural masses. The essentially urban focus of the CRBs on the other hand is illustrated by their representation largely in urban commercial districts, eg. Gampaha 126 and Colombo 84. The CRB experiment by the People's Bank, in collaboration with the co-operative movement, was aimed fundamentally at taking banking to the rural areas. This resulted in the number of persons per bank branch office which was as high as 40,433 in 1970, decreasing to as little as 8567 in 1992. However, the experiment of the People's Bank through the CRBs, and the Bank of Ceylon through its ASC branches, with the rural sector, has helped largely to enhance the deposit resources of the two banks, especially of the People's Bank, very efficiently, by a flow of funds from the hitherto untapped rural sector to the urban city centres.

In achieving the broader objective of taking banking and institutional credit to the rural poor, the RRDBs have had to take cognisance of the consumption needs, as well, of the rural population they cater to. It is in this regard that it has had to undertake pawning operations, which it is legally enabled to do, on behalf of its rural customers. As at 30.6.1992, 14.4 per cent of total loans disbursed by the RRDBs were pawning advances which are mainly for unproductive purposes. It is significant therefore that loans granted under the pawning scheme of the RRDBs at end December, 1992 increased by 96 per cent over the previous year with the number of loans

too granted under this scheme increasing by a similar percentage. This is ample evidence of the growing consumption needs of the rural sector, the significant increase of which, over the previous year, is in sharp contrast to a marginal increase in industrial and commercial credit from 23 per cent in 1991 to 25 per cent in 1992 and a decrease in agricultural advances from 52 per cent in 1990 to 40 per cent in 1992.

In assessing the performance of the RRDBs in serving the rural sector, of significance is an overall credit/deposit ratio of 1.05 registered by the RRDBs as at end December, 1992. This amply signifies the role of the RRDBs in serving the credit needs of the rural poor. The surplus of credit disbursed, over deposits mobilized, is met largely by refinance from the Central Bank. The average credit/deposit ratio per district as at 30.6.1992 was 2.0 which signifies that the credit disbursed by the RRDBs is twice as much as the deposits mobilized by them.

### **OBJECTIVES AND FUNCTIONS OF THE RRDBs**

The primary objective of the RRDB can be stated to be the development of the rural economy by providing for the development of agriculture, cottage and small-scale industries, the fishing industry, commerce and other developmental activities in rural areas. Thus, wherever the Central Bank feels there is scope for the development of the rural economy, it shall endeavour to establish an RRDB with the objective of promoting agriculture, industry, fishing and other commercial activity which will, in turn, result in the general upliftment of the rural economy and create avenues of employment for the rural population.

In achieving these objectives the functions of the RRDBs are stated to be as follows:-

- 1) To grant short-term, medium-term and long-term loans and other accommodation, particularly to farmers and agricultural labourers and to co-operative societies and marketing and processing societies for agricultural purposes.
- 2) To grant financial accommodation to artisans and other persons engaged in all types of rural development activity which are of a small scale.
- 3) To open and maintain current, deposit, savings and other accounts.
- 4) To carry out all types of commercial banking operations except foreign exchange operations.
- 5) To provide safe deposit/safe custody facilities.
- 6) To manage property, both movable and immovable.
- 7) To transact all kinds of agency business normally carried out by bankers.
- 8) To borrow or raise money and to secure the prompt repayment of such money borrowed, by the mortgage, charge or lien upon the property or assets of the Bank, including its uncalled capital, and, in a similar manner, to secure and guarantee the performance by the Bank of any obligation or liability it may undertake.

- 9) To lend and advance money on securities and property and give credit, as it may deem fit, with or without security.
- 10) To assist and promote the marketing and processing of agricultural produce and industrial products, and the marketing of fish and processing of fish products.
- 11) To acquire, or purchase, any movable or immovable property or agricultural, industrial, commercial, or other, enterprise and to manage, or arrange for, the management of such property or enterprise.
- 12) To carry on the business of pawn broking.
- 13) To undertake rural development projects which are of a small scale, including pilot projects, in order to achieve the objectives of the bank.
- 14) To promote rural development through ecological reconstruction and the improvement of villages and to provide advisory assistance in this regard eg. encourage activities such as replanting etc..
- 15) To engage in and promote the construction of, warehouses, godowns, stores and buildings in rural areas for agricultural, industrial and related activities.
- 16) To enter into any agreement with any banking institution, or co-operative society, for the taking over of any undertaking or project which is financed by that banking

institution or co-operative society or, which is being carried out by such banking institution or co-operative society.

- 17) To open deposit accounts in the Central Bank, any commercial bank or co-operative society and, with the approval of the Monetary Board, in any bank or financial institution outside Sri Lanka.
- 18) To lease, let on hire or sell on a hire-purchase basis, warehouses, go-downs, stores etc. in rural areas and machinery and equipment and other goods.
- 19) To purchase or acquire shares in co-operative, marketing and processing societies and other types of co-operative societies, to lend infra-structural support to its lending operations.
- 20) It is empowered to deal with immovable or movable property.

It is evident, therefore, that the RRDBs have sufficient legal force to assist the entire process of rural development through the generation of agricultural and industrial activity, self-employment projects etc. and assist in the provision of the support services necessary to complete the process of rural development such as provision of storage and marketing facilities and advisory services.

Their ability to accept public deposits and conduct general banking business - all types of banking operations except for foreign exchange operations - gives them commercial banking status. They are thus governed by the provisions of the RRDB Act as well as by the provisions of the Banking Act.

## **THEIR ESTABLISHMENT**

Where the Monetary Board of the Central Bank considers it necessary that a RRDB be established for the purposes of developing the rural economy, the Monetary Board may, by an Incorporation Order published in the Government Gazette, state the following:-

- 1) Declare that the Bank be established for the purpose of developing the rural economy by providing for the development of agriculture, cottage and small-scale industry and other development activities, in rural areas;
- 2) Assign a corporate name to the bank;
- 3) State the area within which the bank shall operate;
- 4) State the principal place of the business of the Bank;
- 5) Fix a date on which the bank shall commence business; and
- 6) State the names of the persons appointed as the first members of the Board of Directors of the Bank.

Since it is a commercial bank and is governed by the provisions of the Banking Act, it is required to meet the licensing requirements of the Banking Act as well.

## MANAGEMENT

The management of a RRDB lies with the Board of Directors which consists of five Directors including the Chairman. At the time of establishment of a RRDB, the Board of Directors is nominated by the Monetary Board with the concurrence of the Minister of Finance. However, after a period of two years from the date of incorporation of an RRDB, of the entire share capital which is owned by the Central Bank, 49 per cent may be offered to the indigenous commercial banks and to co-operative societies. Upon such transfer of shares, two of the five directors of an RRDB would be elected by its general body comprising the nominees of commercial banks and co-operatives to whom the shares have been transferred. A Member of Parliament, a member of a District Development Council or any local authority is not eligible for appointment or election as a Director of an RRDB. The term of office of a director shall be five years. The Chairman of an RRDB is its Chief Executive and is appointed, from amongst its Directors, by the Monetary Board, with the concurrence of the Minister. Section 10 (2) of the RRDB Act gives the Monetary Board the power, with the concurrence of the Minister, to terminate the Chairman's appointment without assigning any reason and such termination will not be questioned in any Court of Law.

Most of the existing Directors of the RRDBs are from the districts themselves and are, therefore, familiar with the local community and are able to evolve policies to meet the local requirements. They are, generally, people who possess the necessary

motivation and organizational capacity and are generally recruited for their long experience in banking, in particular, in agricultural credit, and their responsiveness to the concept of rural banking.

Agricultural credit by the commercial banks has been a failure primarily because the staff assigned to agricultural branches are, very often, urban oriented and lack the attitudinal approach necessary for rural banking. This aspect of staffing in the RRDBs is given very careful consideration and preference has always been given to officers who have a rural orientation and display an aptitude for rural development. The staff requirements are maintained at the barest minimum and the branches are generally manned by a branch manager and three or four clerks who serve as field supervisors as well. The total strength of the RRDBs' staff as at 30.06.1992 was 1,094.

## **CAPITAL AND SOURCES OF FUNDS**

### **Share Capital**

The authorized share capital of an RRDB is 50 million rupees divided into 500,000 shares of 100 rupees each. Its issued share capital however is 30 million rupees and is subscribed in full by the Central Bank. The Central Bank may increase the share capital whenever it is deemed necessary. Although, initially, the entire share capital of each bank is subscribed by the Central Bank, under Section 20 (3) of the RRDB Act, the Central Bank may, after a period of three years from the date of incorporation of the Bank, offer 49 per cent of the issued capital to commercial banks incorporated in

Sri Lanka and to co-operative societies. The aggregate share holding of a co-operative society however has been limited to 10 per cent of the issued capital.

### **Reserves**

The RRDB Act also provides for the establishment of a General Reserve Fund and a Special Reserve Fund which will be built up by a transfer out of the bank's annual profits. The Special Reserve Fund also acts as a provision for bad and doubtful debts.

There is also provision for the establishment of a Special Resources Fund to which grants and donations from local and foreign organisations may be credited. This fund does not form part of the general funds of the bank and shall be maintained as a separate fund administered by the bank on behalf of the Sri Lanka Government, foreign government or international organization as the case may be.

A Staff Development Fund required to be set up under the Act would meet the expenditure incurred by the bank in securing specialised services.

### **Borrowings**

In addition to the refinance facilities from the Central Bank, an RRDB can also borrow loans, on a temporary basis, from the Central Bank, for periods not exceeding 6 months. These borrowings shall, at any time, not exceed 10 per cent of the bank's paid up capital and free reserves. The bank is also empowered, with the prior approval of the Monetary Board, to borrow from the Government

of Sri Lanka, which monies shall be lent through the Central Bank out of the Consolidated Fund. These borrowings need to have the approval of Parliament. An RRDB can, for its purposes, with the prior approval of the Monetary Board, also borrow from any foreign government or any other source whatsoever outside Sri Lanka.

## **Deposits**

Although the RRDBs are enabled to accept all types of deposits from the public, in preserving their image as a poor man's bank, they have consistently mobilized only savings and fixed deposit accounts. By the non-maintenance of current account facilities for their customers, they have effectively kept out the trading and business community who, it is considered, have access to the other commercial banks for this purpose. To this extent, therefore, they do not offer the full range of banking services, normally available at commercial banks, which keeps operating costs for the RRDBs at the barest minimum.

The flexibility they enjoy in being able to fix their own deposit and lending rates has made them very competitive with the commercial banks whilst, at the same time, giving them a high cost of funds.

Their deposit mobilising efforts are conducted at grass-roots level where meetings at village level, commonly known as "Janahamuwas," are conducted and where the villagers are educated as to the advantages of deposit schemes available at the bank. Deposit accounts are opened for customers at these meetings which is, in itself, a dynamic concept and has brought in the desired results.

Depositors over 16 years of age with RRDBs have the advantage over their counterparts in the other commercial banks, of being able to, in terms of Section 38 of the RRDB Act, nominate a beneficiary in the event of death with the provisions of Section 44 of the National Savings Bank Act applying in this regard.

Total savings and fixed deposits mobilised by the RRDBs in 1992 recorded an increase of 52 per cent over 1991 while the total number of deposit accounts opened recorded an increase of 35 per cent during the same period. The RRDBs have embarked upon an aggressive deposit mobilisation drive through innovative saving schemes and through the implementation of a compulsory savings scheme to achieve these results. The increase of 52 per cent in total deposits mobilized by the RRDBs in 1992 is significant in the context of only a 23.1 per cent increase in savings and fixed deposits mobilised by the NSB and the commercial banks in 1992.

### **Refinance facilities from the Central Bank**

To be eligible for facilities from the Medium and Long Term Credit Fund of the Central bank, which is its refinancing arm, a banking institution has to be deemed to be a credit institution. Section 41 of the RRDB Act gives it this status. Refinance is thus made available at concessionary rates of interest, which have ranged from 9 per cent to 16 per cent over the years to the RRDBs who, in turn, on-lend these funds at rates which ranged from 14 per cent to 19 per cent. Various credit schemes eligible for refinance, which were hitherto administered by

the State Banks, are also now administered by the RRDBs. Cultivation loans made under the New Comprehensive Rural Credit Scheme (NCRCS) are also eligible for 100 per cent refinance which are at very low concessionary rates of interest, viz. 8.5 per cent for on-lending at rates not exceeding 16 per cent. (The rates applicable at the introduction of this scheme were 1.5 per cent and 9 per cent respectively which have been progressively increased over the years). As at 30 June, 1992 total refinance availed of by the RRDBs aggregated Rs. 391.9 million which constitutes 42.4 per cent of total loans and advances made by the RRDBs as at this date.

The interest spread enjoyed by the Banks eligible for refinance under the NCRCS (generally called participating credit institutions or PCIs) is an added incentive, in addition to the refinance available, for the maximum effort of PCIs under this Scheme. The RRDBs' share of total cultivation loans disbursed by the Commercial Banks under the NCRCS has increased from 16.2 per cent in 1990 to 22.3 per cent in 1991 to 26 per cent in 1992.

### **SPECIAL CONCESSIONS MADE AVAILABLE TO THE RRDBS**

In recognition of the national importance of the role of the RRDBs in uplifting the rural economy, several concessions have been made to them by the Government of Sri Lanka. These concessions are aimed at easing the pressure on their profitability, by the very nature of their lending operations in high risk areas of the economy. The special concessions enjoyed by them over their counterparts in the industry are as follows:-

## **(1) Financial Support from the Central Bank**

- (a) The capital of the RRDBs is cost free in that it is contributed entirely by the Central Bank and does not entail any financial cost for the RRDBs. Most of these funds are, in turn, invested in Treasury Bills which earn for them market rates of interest;
- (b) The initial expenses in setting up an RRDB are also met by the Central Bank by way of an outright grant;
- (c) Their staff costs too are subsidized by the Central Bank by way of secondment of Central Bank staff to man the RRDBs and whose salaries are met by the Central Bank. The cost of training the staff of the RRDBs is also borne by the Central Bank.

- ## **(2) Exemption from Reserve Requirements**
- The Reserve Requirements imposed by the Central Bank on Commercial Banks is an instrument of monetary policy through which the Central Bank contains the money supply. By this requirement, all Commercial Banks are required to keep 15 per cent of their Sri Lanka Rupee and foreign currency deposit liabilities with the Central Bank as interest-free deposits. (This ratio may vary from time to time). This requirement not only strains the liquidity of the Commercial Banks, but also

raises their cost of funds. The RRDBs are exempt from the provisions of Section 93 of the Monetary Law Act, which imposes the Reserve Requirement, for a period of 3 years from their establishment. For the succeeding 3 years thereafter, they shall be liable to pay only half of the required reserve. This concession is aimed at improving their liquidity in that, not only will these resources be available to them for their day-to-day operations but, instead of being kept in an interest-free account at the Central Bank, these funds can be invested in income-earning assets.

- (3) **Exemption from Income Tax** - The profits and income of the RRDBs are exempt from tax for a period of 10 years from their establishment. At present the Commercial Banks are liable to a corporate tax (inclusive of the surcharge) of 40.25 per cent. This concession granted to the RRDBs would enable them to build up a capital cushion by way of reserves.
- (4) **Exemption from Stamp Duty** - The provisions of the Stamp Duty Act. No. 43 of 1983 which imposes a Stamp Duty on various transactions the Commercial Banks may have with their customers, do not apply to the RRDBs, The effect of this exemption is that the cost of credit to the customers of the RRDBs

is greatly reduced to the extent that, any instrument made, or executed by, any person, in favour of the Bank, in respect of any security for a loan, shall be exempt from Stamp Duty. Withdrawals from savings accounts which are normally subject to a stamp duty of Rs. 2 per withdrawal at the commercial banks are also exempt from such stamp duty. This is indeed a significant advantage when one considers that 88 per cent of total deposits with the RRDBs are in savings accounts. It also helps to reduce the financial costs of the Bank in respect of its day-to-day business wherever it entails the payment of Stamp Duty.

### **HOW DO THE RRDES FUNCTION? -**

#### **A NEW, DYNAMIC CONCEPT IN BANKING**

Sri Lanka's rural community to whom the RRDBs cater primarily, are, traditionally, honest and hardworking and a sector that does not willfully default on their financial obligations. These attributes are a sound basis for a healthy borrower-lender relationship. However, despite many efforts made by the authorities in the past, institutional lending to this sector has not developed to an appreciable extent. Unforeseen circumstances in their lives such as illness or death, may draw them, unwittingly, into the clutches of the indigenous money lender whose unscrupulous terms very often have a crippling effect on the rural poor. It is to these unscrupulous money lenders that the rural poor have very often

lost whatever meagre wealth they may be possessed of. The RRDBs are a means through which this hitherto neglected segment of Sri Lanka's population are offered a means of improving their lifestyles, through an introduction to the resources necessary for some sort of commercial production which the RRDBs are equipped to provide. How do the RRDBs do this for a community who have an inherent fear of institutions ie. Commercial Banks, whose imposing structures very often drive the rural poor away from their door steps?

In order to win the confidence of the rural population, in appearance too, the RRDBs project the image of a poor man's bank by keeping building costs down to the barest minimum and by outwardly exhibiting a very simple facade. The RRDB branch thus, being in direct contrast to the comparative ostentation of a Commercial Bank, is an invitation to the rural farmer to enter its portals and discuss his problems with the Bank. He immediately feels that he is welcome in the RRDB and, above all, feels comfortable, which is in direct contrast to the usual disdain with which the rural poor are looked upon by the conventional commercial banker. The RRDBs were thus born out of the need to remove the rural poor from the clutches of non-institutional sources for their credit needs. It is this awareness by the RRDBs, of the fear of the rural farmer, of institutions like Commercial Banks, that has urged them to develop an entirely new concept in banking in Sri Lanka. i.e. the concept of barefoot bankers. This new approach takes the Banks to the doorstep of the rural farmer - it does not wait for him

to come to the Bank. This approach is not only entirely unconventional but is an entirely new and dynamic concept in banking in Sri Lanka. Especially in the context of the conventional commercial bank approach to the rural farmer, where the Manager, who is invariably not rural oriented, is content to service only those customers who dare to come to him. The villager, who invariably has access to the Commercial Bank, is the village Mudalali and his type and excludes the rural farmer, artisan, labourer or vendor who is hesitant to access institutional sources of credit.

The RRDBs, in introducing this new concept in banking, have organized "Jana Hamuwas" as they are called, or village meetings, where the villagers are acquainted with, and educated on, the role of the RRDB and its objective in meeting their credit needs and in the general improvement of their way of life through the development of the rural economy. By regular and periodical meetings conducted by the Bank in the village centres, the Banks are able to identify projects for the village and associate potential customers with these projects. The "getting to know the villager" process helps enormously in breaking down the barriers that have hitherto existed between the conventional banker and his customer. An immediate rapport is thus established between the Bank and the rural clientele it expects to serve. The friendly relationship that exists between the RRDB and its rural customer, where they are all known by name to the Bank, helps in building up a mutual confidence between the Bank and its rural customer. The efficient servicing of debt, experienced by most

RRDB branches, can be attributed to the fact that the close contact the Bank has with its customers not only ensures the end-use of loaned funds but prevents the evasion of repayment by the customers with whom the Bank has constant physical contact.

Prospective borrowers can discuss their problems at these Jana Hamuwas and with loan applications being available on the spot, bank officials assist customers in filling them up and in apprising them of the requirements of the Bank which they need to comply with. This expedites the credit granting process in a significant manner and saves the customer the trouble of visiting the Bank on numerous occasions which has, invariably, proved a deterrent to the granting of credit by Commercial Banks to the rural sector. There have been instances where borrowers, especially in the rural sector, have had to visit the commercial banks on as many as ten occasions to get their loans processed. In mobilizing deposits at these meetings, mandate forms and specimen signature cards are handed out and filled in and the whole gamut of the account opening operation is run through on the spot which greatly facilitates the mobilization of savings at village level.

The village meetings, which are conducted by the RRDB branch, are a means of mobilizing deposits and effecting recoveries of loans already granted. In effect, it takes the whole banking process to the doorstep of the villager, which has virtually revolutionized the banking process, by changing the mode of banking from the conventional and very conservative methods of commercial banks, with their

aloof approach to customers, to one of personal and intimate contact with customers at grass-roots level. The face of banking has, to this extent, being transformed to cater to a particular sector of society.

An integral component of the staff of every RRDB is the field supervisor. Each branch is manned by at least 2 field supervisors to monitor the end-use of funds disbursed, to ensure that these funds are not diverted to other uses. It is only such close supervision of the end-use of funds loaned by the RRDB that would ensure regular recovery of these loans. The RRDBs are thus adequately equipped with suitable modes of transport for the effective supervision of loaned funds.

### **SUPPORT SERVICES TO BORROWERS**

The extension work carried out by the RRDB covers the provision of the support services necessary for the successful implementation of projects financed by them. In this regard vital components of cultivation projects, like fertiliser and agro chemicals, which form the major part of the inputs for cultivation, are bulk-purchased by the RRDB and supplied on a "no-loss no-profit basis" to the farmer. This helps to reduce the cost of cultivation for the farmer. Veterinary services are also arranged for by the Bank and, very often, it is found that this is the first introduction the villagers have had to the services of a qualified vet.

The success of any productive enterprise lies in the availability of proper storage facilities and a ready market for the goods produced. This is part of the many support services provided by the RRDB to its borrowers. Storage facilities constructed at the

Bank's expense, or leased out by them, ensures that produce is stored in the proper conditions before it is ready for the market - especially during harvesting. Storage and marketing are two of the most neglected aspects of production especially at farm and village level. This accounts for the rapid deterioration of produce and the rejection of large quantities of perishable goods, such as fruits and vegetables, by the market. Whilst providing the necessary storage facilities for produce before it is marketed, it would not be long before the RRDBs venture into the areas of cold storage and dehydration processes to take advantage of seasonal gluts in vegetables and fruits and in other food crops such as chillies and onions by way of financing these ventures, or by their direct involvement in these processes. It is not an uncommon sight to see large mounds of such produce on the road-side being sold for a mere pittance, or lying perishing, for want of a ready market.

In this regard, the RRDBs have ventured into providing, in a limited way, a vital need - transport facilities - for carrying the produce of the farmer and the cultivator to the market. This helps to eliminate the middle-man who is the bane of all primary producers. The RRDB thus provides a type of guaranteed price scheme for the produce of the rural farmer who is financed by the Bank. The farmer is therefore ensured of a reasonable and realistic price for his produce, which he would otherwise have to sell for a very low price to the middle-man, who rakes in the profits by taking the produce off the farmer and selling it at market prices.

Therefore, the RRDB concept in rural banking is a dynamic one in that, even if these support services are not made available by all the RRDBs in operation to date, there is adequate provision in the law to enable them to undertake any of these ancillary functions whenever the need arises. This is of paramount importance in the successful implementation of any rural credit programme.

## **HOW IS RURAL CREDIT INSURED AGAINST DEFAULT?**

A good credit decision is a value judgment based on all the available information on the borrower and the purpose for which the loan is required. Credit officers to whom an applicant for a loan has to go are specially picked for their aptitude to go beyond what documentary proof may disclose. In interviewing the customer he should arrive at a decision whether to grant the credit or not, purely on the basis of his estimation of the borrower's integrity, the viability of the project to be financed and the capacity of the borrower to repay. Such a decision, if it is positive, would not normally entail or necessitate, the provision of security for the loan. To base a credit decision to grant an advance therefore on the merits of the collateral cover available, is to assume at the outset that the loan would be defaulted and that the project is not viable.

Rural credit has been a failure in Sri Lanka because of the insistence by Commercial Banks on adequate collateral, even from the rural poor, for

commercial bank credit. The conventional types of security acceptable to Commercial Banks cannot be offered by the rural poor who, thereby, have no access to institutional credit. The RRDBs who specialize in this field and whose sole function is the provision of rural credit, are adequately equipped to grant rural credit entirely on the basis of the viability of the project to be financed by them. This makes institutional credit accessible to the rural poor through the RRDBs who do not insist on collateral or on guarantors, but depend on the viability of the project financed. The lack of guarantors for loans to the rural farmer has therefore popularized the concept of **inter se guarantees** which means that the borrowers in the rural sector, guarantee each others loans.

Another innovative feature of lending by the RRDBs is the grant of group loans which enables more viable extents of land to be cultivated, instead of small plots, which individuals in rural areas are normally possessed of. Loans for animal husbandry and other productive purposes too are granted collectively to groups of customers. This group loan scheme enables economies of scale in the use of resources and in cutting costs which is more viable in the long run. The collective responsibility that ensues from group loans encourages a deeper commitment to the success of the project thereby ensuring the recovery of the loan. The dependence here is on collateral of a social nature and not, as is common in conventional banking, on collateral of a tangible kind. Loans for projects which entail large capital investment, and which is beyond the

capacity of an individual farmer to undertake, are thus granted on a collective basis to groups of persons eg. for land and for deep water wells.

In the provision of support facilities to its borrowers most RRDBs now act as agents for manufacturers of agro chemicals and agricultural implements and machinery. This guarantees the availability of vital inputs to the rural farmer at very reasonable prices, much less than the market price. The benefits of commission earned by the RRDB in its capacity as agent in this regard may even be passed on to the farmer in the price he has to pay for these inputs. All this helps to bring down the cost of production considerably for the farmer who, in finally selling his produce at the market price, has the benefit of a wider margin of profit.

### **HOW SUCCESSFUL ARE THE RRDBS IN ACHIEVING THEIR OBJECTIVES?**

The branches of RRDBs which are almost, always, in totally unbanked areas, cover a radius of upto 5 to 7 miles of the branch. This geographical demarcation of their boundaries is not only cost-effective for the Bank but ensures that a small area is serviced by that branch more efficiently than if its activities were to be scattered all over the district. It also ensures closer supervision and follow-up of credit granted, which, in turn, guarantees high recovery rates. The impact of the success of institutional rural credit is more easily seen and felt over a smaller area than over vast areas covered by the branch. Branches established in these areas

carry out surveys of the credit needs of the population and base their lending strategy on the findings of these surveys.

The success of an RRDB would, however, primarily depend on the dynamism of the Chairman and the Board of Directors under whose direction Branch Managers are expected to function. Operational autonomy, by way of flexibility and freedom in decision making, has been granted to the Chairmen of RRDBs who do not have to come to Colombo for directions. This allows them all the flexibility necessary to decide the best development strategy for the district and to conduct research and orient their policies to suit the needs of the locality. It is, therefore, a firm commitment on the part of the Chairman and his team, to make rural lending viable and successful, for the benefit of the rural poor, that can make the whole RRDB concept a success.

The Puttalam RRDB is a case in point where the dynamism of the Chairman has resulted in the development of the prawn culture project in the Kalpitiya area by small holders, very successfully. Prawn culture has, hitherto, been the preserve of big corporate entrepreneurs, entailing large capital investment. The Puttalam RRDB was successful in identifying projects in small extents of 25 to 30 perches, with an initial facility of Rs. 10,000/-, the success of which has extended these facilities to cover 4 acres and enhanced amounts of Rs. 800,000/- with a recovery rate of one hundred percent ! This is indeed an example of the resourcefulness and

entrepreneurial skills of the Chairman and the staff of the RRDB concerned to venture into projects which have hitherto eluded the small borrower.

Another case in point is the special support services provided by the RRDBs in paddy producing areas where, in times of seasonal gluts, the RRDBs step in and buy up the produce of the paddy farmers and, by providing adequate storage facilities, help to stabilize paddy prices. Farmers in paddy producing areas are normally forced to sell their produce at very low prices or, sometimes, even below cost, due to seasonal gluts and the concurrent lack of storage facilities. The need for funds forces the farmers to sell their produce, instead of storing it and releasing the stocks during lean periods which would help them to sell these stocks very profitably. This is exactly where the RRDBs offer their services to help the farmer and in doing so they have been enterprising enough to seek out the unused silos of the Paddy Marketing Board in these areas and use them effectively for the storage of paddy. This intervention by the RRDBs has helped not only to stabilize paddy prices in periods of glut, but also to meet the immediate liquidity needs of the farmer by way of a pro rata payment being made by the RRDB to the farmer immediately on the purchase of his paddy. The balance payment is made to the farmer by the RRDB after the paddy is sold which is also done on a profit sharing basis. This enables not only the farmer who has borrowed from the bank, but all other producers of paddy, to earn a realistic income.

The RRDBs in vegetable producing areas, especially in the N'Elia district, as well as in low-country, vegetable producing areas, are also very effective in providing a market for the produce of their borrowers in these areas. Vegetables in season, as mentioned earlier, are very often sold at unrealistically low prices by the cultivators to unscrupulous middle-men at whose mercy they find themselves for want of transport facilities to take their produce to market. This is an area that is often neglected by various rural development schemes which fail as a result of the absence of the necessary infrastructure to market the goods produced. This is a vital element of any production plan and should be an integral part of it. Commercial Bank credit to the rural sector has very often failed because once the loan is disbursed the borrower is left to his own devices to find a market for his produce. The RRDB in the Kandy District, where local handicraftsmen abound, and which has financed many of them, has set up handicraft centres for marketing these products in the city. The handicrafts of the customers of the RRDB have even been exhibited by the RRDB at other centres thereby extending the marketing area beyond the locality in which they are produced. Even export orders have been obtained for these handicrafts through the RRDBs which has afforded ready access for these craftsmen to markets for their products beyond the realms of their means and imagination.

Therefore, it is evident that although RRDBs, because of their inability to conduct foreign exchange

operations, cannot be considered to be full-fledged banking institutions, their capacity to go beyond the scope of normal commercial banking operations in performing functions in the interests of developing the rural economy, has helped to maintain the balance. Thus, a disadvantage over the Commercial Banks on the one hand, is matched by a distinct advantage over them on the other. The advantage the RRDBs have over their counterparts in the Commercial Banks in this regard, far outweighs the disadvantages, as the advantages they have are in the interests of achieving their objective which is the upliftment of the rural economy, through the creation of more employment and through the generation of more income.

In ensuring that all viable projects are identified in the areas in which they are located and in ensuring that they do not fail for want of adequate and timely credit, the RRDBs have financed a whole range of activities mostly to small-scale and cottage industries, to the trade and service sectors, for farming, fishing, agriculture and allied activities. The average size of loans granted by them being in the range of Rs. 7,000-8,000 means that they cater almost entirely to the small man.

RRDBs have financed farmers and artisans alike in agricultural projects, dairy and poultry farming, repair workshops, blacksmiths, rural industries, garments, processing and packeting, brick-laying, to name a few. By the provision of a mode of transport to vendors, such as push cycles and motorbikes, they have helped to make them mobile and to extend their area of operation. Loans

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**TABLE 4**  
**PURPOSE-WISE DISTRIBUTION OF ADVANCES GRANTED**  
**DURING THE PERIOD 1985-1992**

(In Thousands)

Purpose	1985		1986		1987		1988		1989		1990		1991		1992	
	No. of Loans	Amount & Percentage	No. of Loans	Amount & Percentage	No. of Loans	Amount & Percentage	No. of Loans	Amount & Percentage	No. of Loans	Amount & Percentage	No. of Loans	Amount & Percentage	No. of Loans	Amount & Percentage	No. of Loans	Amount & Percentage
Agriculture	395	2,027 41.8%	4,234	23,388 35.8%	6,516	34,950 36.4%	8,549	42,272 43.5%	12,631	86,854 56.2%	33,525	281,351 65.5%	34,977	340,615 57.2%	33,024	321,054 45.7%
Livestock	77	554 11.4%	585	4,905 7.5%	1,000	6,353 6.6%	873	5,696 5.2%	862	6,800 4.4%	2,933	18,594 4.3%	2,612	24,339 4.0%	3,441	32,800 4.7%
Small Industries	257	999 20.6%	1,375	8,304 12.9%	2,429	15,229 15.8%	2,905	19,913 18.3%	2,536	17,728 11.5%	4,575	42,381 10.0%	6,460	58,987 10.0%	7,492	81,517 11.6%
Trade & Business	287	790 16.3%	1,394	25,161 38.6%	2,228	33,454 34.8%	2,520	19,955 18.3%	2,437	22,595 14.6%	4,088	49,290 11.4%	5,592	80,006 13.5%	6,753	113,023 16.0%
Fisheries	—	—	—	—	—	—	75	3,727 3.4%	134	4,006 2.6%	365	5,348 1.2%	392	7,964 1.3%	539	12,925 1.8%
Other	88	473 9.9%	655	3,457 5.3%	1,328	6,150 6.4%	2,105	12,156 11.2%	2,120	16,645 10.8%	3,930	32,786 7.6%	10,077	83,392 14.0%	19,460	141,916 20.2%
<b>Total</b>	<b>1,104</b>	<b>4,848</b>	<b>8,243</b>	<b>65,215</b>	<b>13,801</b>	<b>96,136</b>	<b>17,127</b>	<b>108,719</b>	<b>23,720</b>	<b>154,628</b>	<b>47,616</b>	<b>429,780</b>	<b>60,110</b>	<b>595,303</b>	<b>70,709</b>	<b>703,235</b>

Source: Annual Report of Central Bank of Sri Lanka - 1985 - 1992

granted for various mechanical devices have enabled motor mechanics to switch from manually operated repairs to mechanically operated repairs. On a larger scale, they have financed farm equipment such as two-wheel tractors and the setting up of small rice mills.

Even pawning advances are granted for a variety of purposes including agriculture, small industries and consumption and housing. In granting loans for self - employment the RRDBs make provision for the training of youth in various skills and in the provision of various technical skills needed for the trades in which they are employed.

The main focus of the RRDBs' lending, however, is in the agricultural sector for agriculture and related activities. It is not surprising therefore that of total institutional lending to the rural sector the RRDBs have the largest share of agricultural loans. In this regard therefore, they have filled the void that hitherto existed in institutional credit for agriculture. The largest percentage of their total advances has consistently been for agriculture.

### **WHAT ARE THE OBSTACLES TO THEIR SUCCESS?**

The role of the RRDBs as the link between institutional sources of credit in Sri Lanka and the rural sector has projected them as the most vital link today in Sri Lanka's agrarian economy. The policy makers have thus left virtually no stone unturned to make the RRDB concept a success, which, in turn, will reap heavy economic

gains for Sri Lanka. Therefore, any impediments that may exist in the successful implementation of their programmes for the upliftment of the rural sector and in the achievement of their ultimate goal, need to be taken serious note of.

The most significant obstacle hitherto experienced by the RRDBs in their rapid but steady expansion, is the serious lack of staff to man their branches. Rural credit is a highly specialised area, the success of which depends largely on a profound commitment by those involved in its process to the betterment of the rural poor. Together with this commitment one needs to have a benign tolerance of the rural poor together with a firm resolve to better their way of life. Particular attributes are called for by those involved in this process. Branch managers and field supervisors need to be people of the highest integrity, those who will not take advantage of the rural farmer, as is most wont to happen in most agricultural credit schemes in the rural sector. Lack of adequately motivated staff, with the necessary skills in rural credit, has, hitherto, been the greatest handicap faced by the RRDBs in the achievement of their goals. It is imperative therefore that the authorities, in filling this lacuna in the RRDB strategy, take sufficient remedial action to lure bank officers into this field and make it attractive enough for them to make rural credit a career in their path of development.

The administrative machinery of the RRDBs also needs to be strengthened with a view to streamlining operational controls and procedures at the

branches which have been found to be lacking in many respects in this regard. This is primarily due to an inadequate internal audit system at the RRDBs which needs to be strengthened. An adequate internal audit system, which would be uniformly applicable to all RRDBs in operation, is an integral part of the systems and controls of any institution, particularly of a financial institution. An efficient administrative machinery, therefore, needs to be put into place for all RRDBs which would include two vital elements, i.e. the application of an uniform accounting standard, in line with generally accepted accounting principles, and, a manual of operations. The smooth functioning of the administration of the RRDBs is of paramount importance in the ultimate goal of rural development through the medium of the RRDBs which have come a long way since the establishment of the first four banks in 1985. Their financial health and viability should therefore not be constrained in any way which would not be beyond the resources of the authorities to resolve. The operational autonomy they enjoy, which gives them the discretionary power to plot out an appropriate strategy for the achievement of their objectives, and the virtual monopoly they have over the rural sector, should help them to realise, for the rural poor of Sri Lanka, an era of full employment and income levels which are commensurate with their needs, which will turn the tide, not only for them but for Sri Lanka as well.

The RRDB's experiment with the rural sector which commenced in 1985 has developed over the years into a total commitment to a hitherto neglected

but vital segment of Sri Lanka's economy. Such a commitment by the authorities has come with the recognition of the important role the rural sector has to play in Sri Lanka's economic development. The high recovery rates and collection ratios experienced by most RRDBs in operation today have provided a model for the success of rural credit which other institutions in the field of rural credit now wish to take lessons from. However, in emulating their methods and learning from their success, what is most important to remember is that the success of rural credit can only come from a profound commitment to the upliftment of the rural sector and the rural poor who are the backbone of Sri Lanka's economy.

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