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Re- Inventing the Commercial Banking System to Fit Rural Masses in Globalised Framework

Ashok Kumar Madhav¹ and Mervin Felix Caleb²

¹Department of Studies in Commerce, Pooja Bhagavat Memorial College, Mysore, Karnataka, India.

²Department of Commerce and Management, GIMDS College, Mysore, Karnataka, India.

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ABSTRACT

Till 1950s the progress in terms of outreach by cooperatives was limited. This led to the Nationalization of Commercial Banks in 1969 and 1980, to step up credit to rural masses and Regional Rural Banks (RRBs) in mid-1970s. Hence the credit architecture consisted basically of cooperatives, commercial banks and regional rural banks. Further NABARD set up in 1982, further as a part of Financial Inclusion, other financial concepts such as Self Help Groups, Micro Finance Institutions etc. are now being working at both Urban and Rural levels. Added to this the revival Package of Vidyathanan committee (2006), RBI's efforts in 2007 for providing IT support to UCBs etc. All these support extended to the rural communities clearly indicates the improving financial conditions of the rural communities. These areas have become potential and opportunities waits for bankers to start their business in these areas. The present conceptual paper is an attempt to discover and analyze the threats and opportunities for banking institutions in the present globalized context and to offer a reinvented model, which makes the bankers viable and profitable to conduct business in these areas.

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Introduction

The present globalization spree not only is attracting the urban businesses and industry but also there lies a great scope and opportunity for rural masses to enter into the framework and become profitable and beneficial. Rural masses basically face the threat of ignorance and skills in playing with present technological system. Rural masses can make entry mainly through market media by linking themselves with the market mechanisms. Farmer's awareness is mainly focused on the areas of agricultural input and output markets and appreciable extensions towards rural financing institutions and well publicized government schemes. Their links with the market intermediaries are mainly in three areas such as input market, output market and financial markets. Farming communities had experienced a lot of use from these intermediaries and they still continue to use them. More than being beneficial and appearing so, these intermediaries had used, misused and abused these communities for their business and social advantages unduly. Hence there is a need for a formal and efficient intermediary. Banks can become a strong support for these rural masses.

The present conceptual paper attempts to address some issues of rural concern and try to present the role that rural banking system can play in bringing effective change in the rural structure.

In the event of the globalization certain pertinent questions need to be addressed and practical solutions need to be drawn. The comparative development trends between Urban and rural areas show significant bias towards urban centers. The flow of factors such as labor and land from rural areas are quiet significant but equivocal amount of income from the urban sectors are not flowing back to these rural areas. The labor flowing from rural areas get stagnated in urban areas and the incomes get locked up or get spent in the urban set up, without any reciprocity.

The rural masses face a chronic problem of price risk for their outputs, managing cash flows and issues relating to risk management. There arises a need for an effective channel to intervene in this process for addressing the above identified issues. The best available channel that can effectively activate the existing rural system towards positive direction thereby affecting the rural base is the Commercial Banking System.

Commercial Banks are hence forth addressed as Rural Banks in this paper

The same banking system which activated effectively the urban economic structure in the post independent period can be used to perform the same by bringing certain reinvention in its functional administration.

Review of related past studies

The focal point of the study made by **Das and Udaykumar Lal (2002)**, in his book *Banking Reforms in Lead Bank Scheme*, (Deep and Deep Publication, new Delhi) was the critical evaluation of the lead bank scheme in the light of banking sector reforms. He felt that the backward areas should be given more funds for investment in priority sectors and more and more people should be brought under its coverage and the procedures of extending credit should be simplified and there should be least hassle cost.

Nair KNC (2006) in his paper 'Banking and Technology to meet 21st Century challenges', published in *Bank net India*, has discussed the future challenges of technology in banking. The author also point out how IT poses a bright future in rural banking, but is neglected as it is traditionally considered unviable in the rural segment. A successful bank has to be nimble and agile enough to respond to the new market paradigm and ineffectively controlling risks. Innovation will be the key extending the banking services to the untapped vast potential at the bottom of the pyramid.

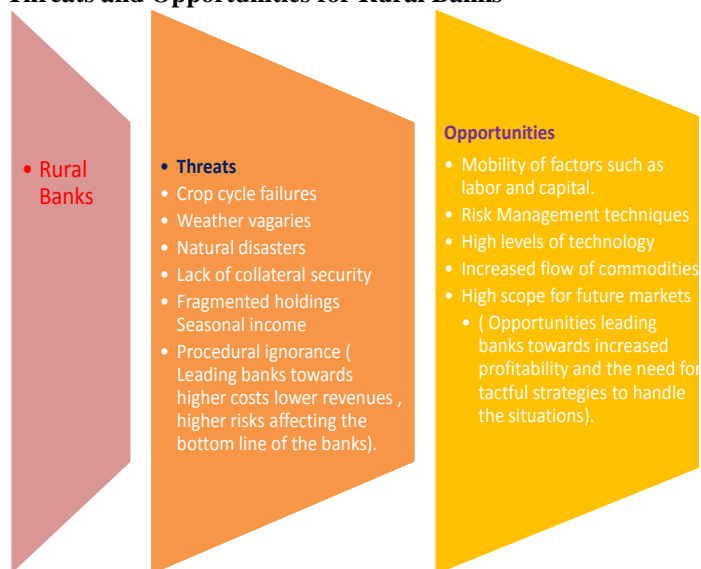
Ballabh (2001) analyzed challenges in the post-banking sector reforms. With globalization and changes in technology, financial markets, world over, have become closely integrated. For the survival of the banks, they should adopt new policies/strategies according to the changing environment.

Kumar (2006) studied the bank nationalization in India marked a paradigm shift in the focus of banking as it was intended to shift the focus from class banking to mass banking. Internationally also efforts are being made to study causes of financial inclusion and designing strategies to ensure financial inclusion of the poor disadvantaged. The banks also need to redesign their business strategies to incorporate specific plans to promote financial inclusion of low income group treating it both a business opportunity as well as a corporate social responsibilities. Financial inclusion can emerge as commercial profitable business.

Focus of the Study

This paper intends to focus mainly on the aspects relating to the role that rural banking system can play a catalyst role in bringing reforms in its functions extending from traditional commercial banking functions towards investment banking in the rural areas. This would bring in change in the structural base of the rural sector. The paper addresses the threats and opportunities for the banks in the event of change that they need to undergo while risking the new business venture.

Threats and Opportunities for Rural Banks



Rural banks which are in the offing with a new set of reformations can make itself highly accessible to the rural communities. The chart above clearly highlights the threats /risks and also the opportunities that are at the disposal of these banks. Banks looking towards rural areas for drawing a new bottom line curve showing profitability at the outset appears to be a task impossible. The threats highlighted indirectly explain the present predicament of the rural financial market. These posing threats had discouraged many governmental and non-governmental agencies to tread into these areas. Of course, the informal financial intermediaries who plays a savior's role for the farming communities had maintained their levels of profitability by using , misusing, abusing and by taking undue advantage of the precarious conditions and ignorance of the rural masses.

Any formal banker entering into this area with a commercial attitude need to closely watch out not only the below mentioned threats but also need to be innovative in arriving at solutions for these problems and attain their bottom line targets.

The major hurdles are

Threats:

Crop Cycle: 70% of the arable land coming under dry region is favorable hardly for a single crop or a double crop in a year. This depends upon the type of crops rotated in that region. The banker can interact with agricultural experts and can give advise to their account holders in maintaining their crop cycle through profitable crop rotation and production system.

1. Weather Vagaries : Regions with dry lands with irrigation facilities and irrigated lands can be a favorable climate for the banker to bank with these rural masses. The unfortunates who sincerely depend upon the monsoon literally, gamble with their investments. This poses a threat for recovery by bankers from their rural account holders. The crop insurance can be an effective tool to mitigate the losses that might occur.

2. Natural Disasters: These events which pose as a major threat for the whole mass which in turn depends upon the help by the government (ex: drought prone areas). The bankers being commercial minded are not really unwise to bank in these areas. The loss that would arise from these rare conditions can be approached by taking a calculated risk. The loss to some extent can be diluted by having straight links with the government in relation to the aid that need to deliver to their account holders.

3. Lack of collateral security: The major requirement for lending is essentially a collateral security. The rural masses being totally depleted, find very hard to fulfill this requirement. For those rural account holders where their counter parts are settled in urban and semi-urban areas can be linked with the income of their counter parts for recovery.

4. Fragmented holdings: Majority of the farmers possess small holdings and also those holdings are already mortgaged to informal financial intermediaries. The banks rarely have opportunity for attaching any property for the recoveries. Under such circumstances, the banker can take the future crop as a mortgage and can adjust for their recoveries. There arises a need for opening a marketing cell by the banks to market the recovered and mortgaged items.

5. Seasonal Income: The income, deposits and repayments for the farmers are highly seasonal in nature. These deliveries will be from the net income received by the farmers from their crops. Farmers facing the problem of working capital and finally running the price risk for their crops generally enter into prior commitments with the informal financial intermediaries for very low bargain with a wrong and ignorant idea about the price movements for their crops in future markets and they get locked up with the informal financial intermediaries. This condition clearly explains the acceptance attitude of farmers towards future markets. They go for future markets under worse conditions and hence settle with lower bargains informally. The banks can help their account holders by educating them about the formal working and profitability that they can earn in formal future markets. The introduction and education of the concepts of derivatives, swaps, options, etc can really help in improving the bottom line of the farmers.

6. Procedural ignorance: Rural masses by and large are quite familiar with various government schemes and their procedures while availing the aid from the government schemes. No doubt, they are helped by other government functionaries for gaining undue economic benefits. These procedural hassles and ignorance about the laws relating to it makes the farmer discouraged to attempt for the same. The new schemes and policies that might come out of the venturing banks might face the problem of gaining accounts. This problem can be solved by

adopting simplified procedures and by the use of new technology.

Opportunities

1. **Mobility of factors:** The factors such as land and labor which are highly mobile in this globalised situation can be opted by commodity markets experts to provide advisory services about the commodity markets after taking stock of the dynamics of the rural market and can channelize the services through their marketing cell, thereby commercializing the farmer's production and also improve the profitability of the bank.

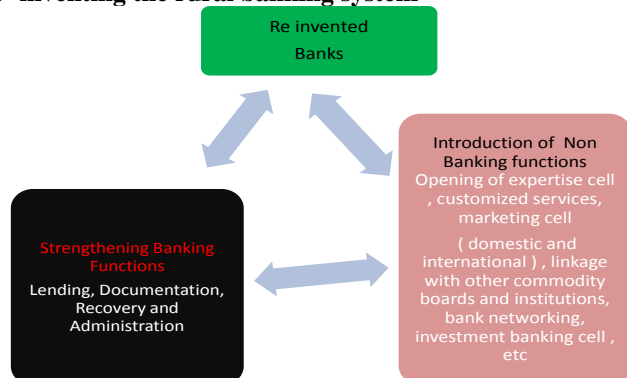
2. **Risk management techniques:** Credit risk management techniques need to be adopted in this venture as they are adopted in case of equity and other future markets. Risk management training should be given to the banker. No doubt, the farmers cannot venture to this field, but the banks can intervene and help themselves and also the farmers.

3. **High levels of technology:** The present technology need to be used to educate the rural masses to increase their sales. Extra efforts in educating the farmers necessitates the modification of the technological systems and make it rural friendly. Internet, emails, ATMs, etc can be trialed in fertile rural areas initially and can be rolled out to other rural areas.

4. **Increased flow of commodities:** By and large our farmers face the problem of price risk by not properly equating demand and supply positions. Demand and supply positions vary from market to market which our farmers are not able to capitalize by adopting the strategy of segmented sales. Banks with help of lower cost technology can offer information and advises to the farmers through their marketing advisory cells. This helps them in timely recovery of their loans and also fetch better bargains for farmers.

5. **Better scope for future markets:** The entry of FDIs into retail sector had expanded the scope not only for consumer goods but also agricultural goods. Many malls and super markets selling commodities are informally entering into future contracts with the intermediaries and commission agents dealing with cereals and pulses. The demand at urban level will be highly diluted by these commission agents when they deal with farmers at farm level. The banks can take opportunity of this situation and help the farmers to enter into future trading through their marketing cells.

Re-inventing the rural banking system



The present farming community which is running with the crisis of cash flow and risk management situations are not merely looking for traditional commercial functions of rural banks such as lending, documenting and recovery, but for those financially trust worthy formal institutions (banks) which can help them in providing lasting and timely solutions for their crisis. It is high time that banks need to reform themselves, modify and simplify their procedures, adopt new policies and be an innovative problem solver. Immediate need arises for a

reinvention of the rural banking system touching the bottom of the pyramid.

Some of the reinventions that can be attempted are as follows

1. Opening of expert cell to handle the issues of rural and commodity marketing. This can be an advisory body linked with the account holder's activities.

2. Customized services need to be unique and important offerings need to extend by the bank. Depending upon the crop, its marketing channel the banking and the non-banking services needs changes. The banker can offer this service based on cropping pattern of those regions.

3. Marketing cell is not only to give advises about the domestic market conditions to the farmers but also to take them to develop links with the international markets through them.

4. Linkage with other commodity boards, institutions, intermediaries, etc need to be developed for extending an expertise service to their account holders. Further, developing a banking network along the lines of the flow of commodities through different channels and areas is required. By this they can exercise control over the commodity and also help the farmers in meeting their target bottom line.

5. Investment banking cells which is quite popular in urban areas with those set of account holders playing in the equities market can also be extended to the farming community with the lower scale investments initially as an investment education and later on convert into a rural investment banking cell.

6. The bankers can rope in agriculture based and other industries into the frame linking with the farmers as a part of the concept of corporate social responsibility (CSR).

Conclusion

The globalised trade which had gained success in urban pockets still need to foray into the rural areas with the dream of success. The rural system which is financially weak needs to be strengthened. Efforts from the governmental and non-governmental agencies had only spelt a trickled down achievements as such. There is a need for a channel which can link them and the markets. The trustable finance channel is banks, but they are limited to perform only commercial banking functions. There is a dire need for them to brace up with non-banking functions also. The paper had attempted to throw light into the areas of threats and opportunities available for the banks and the reinvention need by the banks to mitigate the risks to face the challenge of upholding the bottom line curves of the bank and also its rural account holder. This can bring in a structural change in rural areas and these reinventions helps farmers to gain access to the benefits of globalization.

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