Structure and Growth of Agriculture Finance
Lessons from India
For
AgriFin- World Bank

By Brahmanand Hegde
March 7, 2011
Overview of Agriculture Finance

Institutional Framework

Role of Government

Current Performance

Lessons Learnt

Relevance to audience
Agriculture is Vital to Indian Economy

Agriculture Contributes

- About 15% of GDP: GDP contribution has come down from over 50% in the 1950s to 15% in 2010

- Over 55% of people employed in agriculture and allied activities even today: largest livelihood for rural & low income segment

- Over 650 million tons of production, out of which about 230 million tonnes of food grains

Government has initiated number of programs to develop agriculture and increase flow of formal credit to Agriculture & allied activities
Agriculture is Vital to Indian Economy - contd....

- Largest producer of milk
- Second largest producer of food grains, fruits, vegetables etc
- Over 32 million farmers have received production credit by Commercial Banks
- Over 17.5% of aggregate bank credit is towards agriculture sector (Direct and Indirect)

Government has initiated number of programs to develop agriculture and increase flow of formal credit to Agriculture & allied activities
RBI and Government have been taking steps to increase Credit flow

- Agriculture Finance in India has proactive policy support from Government and Regulator
  - Priority sector benefits and broad basing definition of agriculture credit to include certain infrastructure- cold chain, processing, etc
  - Push by RBI and NABARD through direct and indirect support
  - Multiple channel approach - Public and Private Scheduled Banks, RRBs, Co-op Banks and NBFCs
RBI and Government have been taking steps to increase Credit flow - contd...

- Credit flow to agriculture has grown 3 times during last decade
- Dominance of short term production credit
- Most of the current lenders have short term bias
- Refinance support to commercial banks for long term credit

Aggregate outstanding of Agriculture Credit as on March 31, 2010

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Outstanding in Rs.bn</th>
<th>% contribution</th>
</tr>
</thead>
<tbody>
<tr>
<td>Scheduled Banks</td>
<td>3707</td>
<td>72</td>
</tr>
<tr>
<td>RRBs</td>
<td>458</td>
<td>9</td>
</tr>
<tr>
<td>Co-op Banks</td>
<td>994</td>
<td>19</td>
</tr>
</tbody>
</table>
Role of RBI:

- Supervision of Scheduled Commercial Banks
- Credit policy including defining priority sector guideline
- Bank/Branch licensing
- Support to NABARD- apex agriculture bank
Role of NABARD: Under overall supervision of Ministry of Agriculture

- Agriculture finance policy
- Monitoring RRBs and DCCBs
- Refinance support to all banks to enhance credit flow to agriculture and backward regions
- Capital support to DCCBs
Institutional Framework - contd..

• Scheduled Commercial Banks
  • Public Sector Banks: Major shareholder GOI
  • Private Banks
  • Foreign Banks- SPVs, Branches
  • Operate across the country- urban and rural

• Regional Rural Banks
  • Sponsor Banks (PSBs) hold major equity with 15% of equity coming from State Governments.
  • Operate in smaller areas- few districts, primarily rural and semi-urban

All Government owned PSU Banks and RRBs run commercially with independent board.
Institutional Framework - contd..

District Central Co-op Banks
- Operate in 1-2 districts
- State ownership with limited capital inputs from Farmers
- Primarily provide short term credit to farmers through PACs

Land Development Banks
- State owned, area of operation one State
- Setup to provide long term investment credit to agriculture

NBFCs
- Primarily into equipment finance and investment credit, e.g. Tractor, farm equipment, irrigation pumps etc
Each category of institutions service specific customer segments--

<table>
<thead>
<tr>
<th>Institution Category</th>
<th>Target Customer segment</th>
<th>Loan Size- Range</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public Sector Banks</td>
<td>Medium and Large farmers, Companies,</td>
<td>No limit, but most of the loans are below USD 6666.67</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Private Sector banks</td>
<td>Medium and Large farmers, Companies, Farm Equipment finance</td>
<td>No limit, but most loans are between USD 2200 to 11000</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>RRBs</td>
<td>Small and Marginal farmers, Agri Labours, Agri allied households</td>
<td>Normally below USD 1100</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Co-operative Banks</td>
<td>Small and Marginal farmers, Agri Labours, Agri allied households</td>
<td>Normally below USD 1100</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>NBFCs</td>
<td>Large farmers, Farm equipments</td>
<td>No limit, normally between USD 6670 to USD 11000</td>
</tr>
</tbody>
</table>

..While there are some overlaps
## Product focus of institutions vary

<table>
<thead>
<tr>
<th>Institution Category</th>
<th>Product Focus</th>
<th>Interest rate range</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Public Sector Banks</strong></td>
<td>Short term production credit, investment credit and farm machinery loans, dairy loans</td>
<td>7% to 13% depending up on purpose, loan size and customer category</td>
</tr>
<tr>
<td><strong>Private Sector banks</strong></td>
<td>Short term production credit and Farm machinery loans</td>
<td>11% to 18% depending up on purpose, loan size and customer category</td>
</tr>
<tr>
<td><strong>RRBs</strong></td>
<td>Short term production credit, investment credit , loans for agri allied activities</td>
<td>7% to 13% depending up on purpose, loan size and customer category</td>
</tr>
<tr>
<td><strong>Co-operative Banks</strong></td>
<td>Short term production credit, allied activity loans</td>
<td>7 to 11% with exceptions where interest rate is subsidised by States.</td>
</tr>
<tr>
<td><strong>NBFCs/LDBs</strong></td>
<td>Farm equipment loans and investment credit for large farmers</td>
<td>14 to 24%</td>
</tr>
</tbody>
</table>

Overall long term credit to investment is low
Branch outreach in rural and semi-urban areas grown multifold during last 40 years.

### Branch Outreach of Banks

<table>
<thead>
<tr>
<th>Bank Type</th>
<th># of Branches-approx</th>
</tr>
</thead>
<tbody>
<tr>
<td>Scheduled Commercial Banks</td>
<td>67000</td>
</tr>
<tr>
<td>RRBs</td>
<td>16000</td>
</tr>
<tr>
<td>DCCBs- Co-op Banks</td>
<td>35000</td>
</tr>
<tr>
<td>PACs- Co-op societies (functional)</td>
<td>Over 150000</td>
</tr>
</tbody>
</table>

PACs- are primary agriculture co-op societies at village level acting as last mile reach to farmers. PACS are provided funding support by DCCBs.
Eligible customer segments for Agriculture Financing

- Individual farmers
- Farming co-operatives
- Companies engaged in farming/direct cultivation; e.g. tea plantations
- Producer Companies: owned by farmers

While commercial banks can fund all kinds of customer segments, RRBs and Co-op Banks finance only select customer segments.
Wide range of customer segments get funding from banks

Eligible customer segments for Agriculture Financing

- Companies engaged in post harvest activities, high tech agriculture, green house/poly house cultivation, seed production and marketing etc
- Proprietary, partnership firms into agriculture
- NGOs

While commercial banks can fund all kinds of customer segments, RRBs and Co-op Banks finance only select customer segments
Role of Government

GOI has been very active in directing credit flow to agriculture from 1970’s

- Nationalization of Banks in 70’s
- Establishment of specialized institutions: e.g. NABARD, RRBs, Co-operative Banks/Societies
- Defining Agriculture as Priority Sector and changing certain definitions in line with market changes
Role of Government - contd...

- Access to capital and refinance: RRBs, DCCBs and Commercial Banks
- Continuous review and monitoring and targets
- Risk reduction measures
- Credit guarantee schemes, crop insurance products

GOI through AIC
Crop Insurance Scheme

Coverage:

- Individual owner-cultivator/ tenant farmers/ share croppers
- Farmers enrolled under contract farming, directly
- Groups of farmers / societies serviced by Fertiliser Companies, Pesticide firms, Crop Growers associations, Self Help Groups

Role of Government - contd…
Crop Insurance Scheme

Crops Covered

- Food crops: cereals
- Oil seeds
- Annual commercial and horticulture crops

Risks Covered: Drought, flood, pest, long dry spells preventing sowing and select post harvest losses
Role of Government contd.. steps

- Doubling of agriculture credit
  Banks, Co-ops

- Key Actors
  NABARD, RBI, Banks, Co-Banks
  GOI

- Quarterly Monitoring by RBI

- Refinance support from NABARD to RRBs, Co-banks

- Capitalization of banks by GOI/NABARD

- Incentivizing banks and disincentive for non-performance
Competition in Agriculture Credit is pushing lenders to innovate..

- With increased competition and need to build quality portfolio is pushing Banks to think beyond traditional approach

- Channel Innovation:
  - From branch based approach to partnership with other service providers
  - Partnership with seed, fertilizer and agribusiness companies including dairy companies, food processing etc for last mile reach
Competition in Agriculture Credit is pushing lenders to innovate - contd...

- Minimise cost of credit delivery
- Reduce risk: market linkage and cash flow trapping
- Bring in value addition with credit plus approach
- Bundling: Kind vs cash
- Significant proportion of co-op credit is delivered to farmers in the form of kind- fertilizers, seeds etc
Competition in Agriculture Credit is pushing lenders to innovate.. - Contd..

Product Innovation:

- **Kisan Credit Cards (KCC):** Over 90.6 million KCCs issued till March 31, 2010 by Banks.

- This is a revolving credit and need for fresh application and sanction is avoided.

- A farmer holding KCC can repay interest and principle and automatically the limit is renewed.

- Any additional credit limit could also be reviewed and approved by Bank and the KCC limit get enhanced.
Product Innovation contd...

• This has made process simpler for both banks and farmers and reduced transaction costs for banks.

• Some banks have enabled ATM access to KCC holders and also usage at merchant establishment for purchase of agri inputs.

• KCCs helped framers to access credit timely and resulted in increase in agriculture production.
Competition in Agriculture Credit is pushing lenders to innovate.. - Contd..

Use of Technology

- Banks are increasingly using technology to reduce cost and make access to credit better

- Rural ATMs: Some banks have setup rural ATMs focusing on farmers access to banking services at strategic locations like APMCs, Agri Service Centre's etc

- Use of Point of Terminal (POT) devise for facilitating credit delivery at merchant establishment
Use of Technology contd…

• Use of smart cards to facilitate transaction: disbursement as well as collection

• Core Banking, even RRBs and Co-op Banks are moving 100% of their branches under core banking.
Key lessons learnt

• India’s agri finance has been result of over 40 years of policy and capital support by GOI & RBI
• Capital support to PSU Bank and Co-op Bank strategy
• Benefits to Agriculture lenders
• Rural branch licensing is fully liberalized
• Extensive branch outreach helped to increase credit flow in rural areas
• Product and channel innovation coupled with use of technology is helping banks and other lenders to bring downs cost to serve
• Small and marginal farmers have limited access to financing by banks
• Need for different channel approach to service small farmers. E.g. MFIs
• Business facilitators: Introduced 4 years back need to scale up
• Inheritance law: resulting in fragmentation of land holding
• Non farm sector was kept out by banking sector
• There is no sub target for non farm lending
• Regional disparity in credit flow on account of uneven branch outreach

• RBI and GOI should encourage new players to bridge this gap. For example, MFIs/NBFCs have lower cost of delivery and they should be encouraged to enter these geographies to bridge the gap.

• End use of Agriculture Credit

• Need to build micro infrastructure to enable better use of credit: Agri information centers, soil testing, quality testing etc
Lessons Learnt - contd..

- Encourage investment credit
- Improve market and value addition to agri. produce, to improve the profitability of Agriculture
- Definition of Agriculture credit needs broad basing to include post harvest and value addition infrastructure
- Push by GOI, RBI and NABARD
- Improve insurance coverage to reduce risk to both farmers and lenders. About 60% of the farming in India is rain fed and need to cover rainfall risk
Lessons Learnt - contd..

• Political interference:

Some States have taken short term view and waived agriculture loans for political gains. Such short term measures results in loss of repayment culture. Instead States should focus on building farmers capacity to withstand shocks, risks and ability to repay.
Access to credit is important consideration for farmers and for agriculture growth

• Need to make lending attractive to banks

• Policy

• Risk reduction: crop insurance

• Cost of delivery: Use of technology

• Channel flexibility: Business facilitators, partnership with alternative service providers like agri. processors, seed and fertz. companies etc.

• Increase healthy competition by allowing new low-cost players on equal footing: e.g. MFIs, NBFCs
Access to credit is important consideration for farmers and for agriculture growth

- Political risk should be minimized to attract bankers to finance farmers
- Incentivize investment credit
- Broad base definition of agriculture to include infrastructure like warehousing, packing and grading facilities, transport of agri. products etc.
- Innovate on product: KCCs
To Summarise

• Regulatory framework needs to be favorable and attractive for financiers to enter this field

• Incentivise Banks/other lenders

• Easy access to capital and lendable resources

• Channel structure need to be appropriate to service small farmers

• Closer to customers

• Low cost
To Summarise - contd...

- Risk associated with the business needs to be minimised
- Crop risk
- Political risk
- Credit risk
- Definition of Agriculture Credit need to be broad-based
Thank You!