

# THE HINDU

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## Open Page

### Indian financial system: challenges ahead

**A.V. Vedpuriswar**

THE INDIAN banking system is failing to discharge its basic responsibilities. Banks are simply not playing the role expected of them in a developing country, which is to channelise savings of individuals into productive wealth creating activities such as industrial projects. The Finance Minister and senior RBI officials keep reminding the banks that it is their 'dharma' to lend to industrial borrowers, especially the small & medium enterprises (SMEs), for whom a special package has been recently announced.

At the recent annual general meeting of the Indian Banks Association (IBA), the Finance Minister lamented that credit off take is not picking up despite the strong economic growth. But bankers think that dharma lies not in doing what the government is telling them but in doing what gives them a decent profit! Small scale units and the poor people are clearly not on their radar screen.

Because banks are not lending to them, the poor are not sitting idle. Vegetable vendors in some parts of the country are known to borrow from moneylenders at an interest rate of 10-15 per cent a day. That works out to 3500-5000 per cent per annum. Similarly, fishermen in West Bengal depend heavily on informal sources of finance available at very high interest rates. The traditional methods of credit appraisal, which attach a lot of importance to documentation, collateral and regularity of cash flows, are clearly preventing banks from exploiting the exciting opportunities which the rural poor offer.

#### Flexibility

Our formal banking system can learn many a lesson from moneylenders. Though they have earned a bad name for the way they fleece the poor villagers, these moneylenders show a remarkable flexibility in the way they operate. They do not insist on any documentation but their understanding of borrowers is thorough. They have a pretty good idea of a borrower's ability to repay a loan.

Some banks in India are claiming that they are giving a new thrust to lending to the poor. That is why there is so much hype about microfinance these days. But the progress made so far is limited. And there is considerable exaggeration and unwarranted media publicity about this limited progress. One foreign bank has prepared a CD on how it is going about discharging its responsibilities in the area of microfinance. The bank has lent less than Rs. 2 crores but is circulating the CD at virtually every forum available to generate wide publicity.

Another high profile Indian private sector bank has announced various initiatives to serve the rural poor. But all that it has done is clever manipulation of the system. For example, it finances the purchase of luxury cars in rural areas. It also transfers loan portfolios from urban branches to rural branches to make it look as if rural lending is picking up.

It is in this context that the much maligned public sector banks should be given a round of applause. State Bank of India (SBI) has built a fairly big portfolio in the area of micro finance. SBI officials seem to be

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discharging their duties in rural areas of the country with a missionary zeal. The bank has even started a housing loan scheme for some self help groups. These are not politically directed loans, but commercially viable ones given to people who are serious about using the money productively and repaying the loan. We need to encourage the public sector banks to continue the good work they are doing.

For lending to the poor to pick up, we need simple innovations. Take the case of cows, on which many villagers depend for their livelihood. Many banks give loans to villagers for purchase of only milch cows. But milch cows are expensive. They are like blue chip stocks. On the other hand, non milch cows are like start ups with low valuation, but have tremendous future potential. The only problem with these cows is that the repayment of loan cannot start immediately. If only banks would give a moratorium on loan repayment, it would be a win-win situation. Not only that, the chances of loan recovery would also improve significantly as the returns on the investment would be quite good.

The major challenge the country's financial system faces today is to bring informal loans into the formal financial system. That would not only provide a huge business opportunity but also serve a social purpose by significantly reducing the interest rate the poor have to pay. That calls for genuineness of intent, flexibility and hard work.