MicroSave India Focus Note 3

The Credit-Deposit Ratio – Time for a Re-Think?

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It was in 1980 that the Reserve Bank of India (RBI) first advised public sector banks (PSBs) to achieve a CDR of 60% in their rural and semi urban branches on a continuing basis. This was done in order to encourage the reduction of inter-regional imbalances in credit delivery and to persuade banks to lend in the same rural and semi urban areas where they mobilised deposits. In both in concept and origin this target was provided as an "advisory" to banks, in order to correct the rural-urban bias in their lending portfolios. The CDR was not meant as a yardstick to evaluate the performance of PSBs at the regional, state or district levels.

And yet, to all intents and purposes, the CDR is now seen, and often quoted, as a yardstick to assess the commitment of PSBs to the rural and semi-urban sectors. One of the most striking aspects of microfinance in India for outsiders is how infrequently the need for financial services for the urban poor is discussed. While endless papers are presented in innumerable conferences on rural finance, nearly 30% of India's poor people live in the urban environment. The urban poor also need a variety of financial services to increase their income and to reduce their vulnerability, to send the children to school and to buy medicines when they are sick. Microfinance has been very successful in urban environments in many countries around the world, not least of all Bangladesh where the slums are every bit as volatile as here in India. Furthermore the density of population in the urban environment means that bank officers and their clients do not have to travel the large distances required in many rural areas, and thus this market is easier to serve on a sustainable, commercial basis.

Despite the pressing needs of the urban poor for access to financial services, the emphasis in India continues to be on meeting the rural needs of the rural poor. In the words of the Government of India constituted Expert Group on the Credit-Deposit Ratio (which reported early in 2005) "Historically, the Credit-Deposit Ratio (C-D Ratio) has been a measure of banks' performance in lending." In particular, the CDR has been used as an indicator of PSBs duty to offer rural finance - the question is whether it is a useful indicator.

The Expert Group provides an overview of the trends of the CDR over the last thirty two years, "Although between 1972 and 1990 the CDR at the All India level fell from 66.4 to 60.7, the ratio improved in many less developed States and regions. … Between 1990 and 2000, the CDR at the All India level declined from 60.7 to 56.0." The Expert Group notes that the recent declines in the CDR have been most marked in the North- Eastern (from 54.9% in 1990 to 29.8% in 2004) and Southern (from 82.4% in 1990 to 68.1% in 2004) regions and that the Northern and Western regions have seen a significant increase in the ratio over the same period.

These apparently inconsistent trends mask significant district variances and are compounded by the fact that, as the Expert Group point out, the CDR is often a misleading yardstick. Part of the CDR decline may well be as a result of more stringent provisioning requirements and policies of the banks. As one of the bankers consulted in West Bengal noted to the Expert Group, the CDR has gone down partly as a result of write off of loans in recent years. This cleansing of the banks' balance sheets is essential for the long-term viability of the rural financial system. In other areas, such as Kerala, where loan collection has been effective, this success has also depressed the CDR. In addition, there are also a growing number of sources of credit such as education loans, microfinance, housing loans, small trade, retail loans, etc. outside the PSBs which are not counted in traditional measures of the CDR.

These growing alternative sources of credit reflect the diversity of needs for financial services within rural households. Indeed poor households need financial services in much the same way as more affluent households do – to borrow not just for their businesses or agriculture but also to build or repair their houses, to buy more expensive capital items and in response to emergencies and so on. Furthermore, contrary to the myth that the poor are "too poor to save", their vulnerability to sudden crises and shocks and indeed their aspirations for their children are such that they are "too poor not to save". Evidence from all over the world suggests that the poor want and need to save, and indeed are saving in a wide variety of ways. In addition to traditional ways of saving "in-kind" (in livestock, tin roofing, jewellery etc.), the poor have created an extraordinary variety of their own systems for saving money: peripatetic savings collectors, reciprocal arrangements between family, friends and neighbours,

marriage and funeral funds, annual savings clubs, chit funds, cooperatives and so on. This, of course has significant implications for the dependence on the CDR as an indicator of the health of rural finance in India.

But there are still more problems with the CDR as a yardstick, in the words of the Expert Group, "Although CDR is generally computed on the basis of data relating to credit outstanding as per the place of sanction, a better indicator is credit as per [the place of] utilisation …", since a significant proportion of rural and semi-urban credit is sanctioned in cities and metros, but used in the villages and towns. As the Expert Group notes, "The CDR for rural branches which stood at 48.6 as per sanction as at the end of March 1995, improved to 64.7 in the same year if credit is computed as per utilisation." With the impressive improvement in communication in India over the past decade, banks have understandably centralised some of the decision-making on sanctioning credit … and as communication improves still further and e-banking solutions extend into the rural areas this trend is likely to continue and grow. And with it so the disparity between the CDR calculated on the basis of place of sanctioning and the CDR calculated on the basis of place of use will also grow.

More provocatively, many would note that with over-indebtedness as a persistent problem in rural India, it might be time to place greater emphasis on assisting the rural poor to save. We have already discussed the importance that poor people place on have access to secure and accessible savings facilities. However, many studies have already demonstrated that well in excess of half (indeed the 1999 Task Force on a Supportive Policy and Regulatory Framework for Microfinance estimated as much as two thirds) of borrowing by the rural poor is for consumption purposes. According to the recently completed World Bank-NCAER Rural Finance Access Survey, 2003, well over one-half (58%) of rural households do not have a bank account – and are thus left stranded in the risky informal sector. Poor people's ability to curb frivolous spending, and protect precautionary savings in readiness for the crises that so regularly affect their households, is severely compromised if much of their savings are held at home or in a village savings club. Perhaps we should be looking to encourage banks to decrease the CDR by offering accessible and appropriate savings services for this section of society in order to help reduce their vulnerability in preference to leveraging their risk by providing them credit!

There is perhaps another, more worrying, reason that is already encouraging banks to decrease their CDR. In 2004, a World Bank report concluded, "For [Regional Rural Banks] RRBs and cooperative banks, poor performance on capital adequacy, profitability and asset quality indicate that there are serious issues across critical financial parameters and indicate that systematic and drastic change in the way [Rural Finance Institutions] RFIs are operating needs to be made urgently if these institutions are to continue playing an important role in the provision of rural finance services." These problems are primarily driven by state interference through directives on deposit and lending rates, lending priorities etc. or postponing/waiving of recovery of repayment of loans given by cooperatives. With the resulting credit indiscipline, and the rural finance system in India in such a perilous state, from an institutional point of view it may indeed be prudent not to lend many cases. Indeed the World Bank report notes that, "While the cooperative banks have had a lending focused approach with high CD ratios, the poor quality of assets and low financial margins have led to weak performance on earnings."

In this context, the Expert Group made an admonition essential to address the perennial problem of interference by well-intentioned Stage Governments. It notes, "while banks would be responsible for credit disbursement, the State Government would be required to give an upfront commitment regarding its responsibilities for creation of identified rural infrastructure together with support in creating an enabling environment for banks to lend and to recover their dues."

Where such an enabling environment has been offered, microfinance has flourished and played an important part in development and achieving the Millennium Development Goals to reduce poverty. The remarkable scale and outreach of India's rural banking infrastructure provides the country a unique opportunity to use financial services as a significant poverty reduction tool.

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