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FINANCIAL PERFORMANCE OF REGIONAL RURAL BANKS IN INDIA

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Abstract

The objective of this paper is to investigate whether the restructuring of regional rural banks in India –undertaken in 1993-94 - has helped improve their production efficiency. Several committees have emphasized the need to improve the efficiency of these banks which are an important arm of the rural credit system in India. Improved production efficiency in provision of services would mean lower cost and financially sustainable operations. Production efficiency has been measured using a non-parametric technique of Data Envelopment Analysis (DEA). To measure efficiency most directly, interest income and non-interest income were used as outputs and interest expenses and non-interest expenses were used as inputs. Efficiency scores were calculated for the years 1990 to 2002. Thereafter these scores were compared for before and after the restructuring year (1993-94). The study finds that efficiency of rural banks has significantly improved after restructuring. It seems the policy of the Government of India to restructure these banks has shown positive results and the study recommends its continuance. Regional rural Banks plays a vital role in the agriculture and rural development of India. The RRBS have more reached to the rural area of India, through their huge network. The success of rural credit in India is largely depends on their financial strength. RRBs are key financing institution at the rural level which shoulders responsibility of meeting credit needs of different types of agriculture credit in rural areas. At present, most of the regional rural banks are facing the problems of overdue, recovery, nonperforming assets and other problems. Therefore, it is necessary to study financial performance of RRBs in India. This paper attempts to analyze the financial performance of RRBs in India during the period 2006-07 to 2010-2011. The study is based on secondary data collected form annual reports of NABARD and RBI. An analytical research design of Key Performance Indicators Analysis such as number of banks and branches, deposits, loans, loans, investments and growth rate index is followed in the present study. The study is diagnostic and exploratory in nature and makes use of secondary data. The study finds and concludes that performance of RRBs has significantly improved.

Keywords:
Financial inclusion, Regional Rural Banks (RRBs), Reserve Bank of India (RBI), NABARD, Annual reports, Indian Economy and Rural credit

1. INTRODUCTION

The institute of Regional Rural Banks (RRBs) was created to meet the excess demand for institutional credit in the rural areas, particularly among the economically and socially marginalized section. Although the co-operative Banks and the commercial banks had reasonable records in terms of population group the co-operative banks had a clear urban bias. In order to provide access to low cost banking facilities to the poor, the Narshimhan working group (1975) proposed the establishment of a new set of banks as institution which "combine the local feel and the familiarity with rural problems which the cooperatives possess and the degree of business organization, ability to mobilize deposits, access to central money markets and modernized outlook which the commercial banks have". Rural banking in India started since the establishment of banking

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sector in India. Rural Banks in those days mainly focused upon the agro sector. Regional Rural Banks in India penetrated every corner of the country and extended a helping hand in the growth process of the country.

2. LITERATURE REVIEW

Haslem (1968) revealed that the internal determinants originate from the balance sheets and the profit and loss accounts of the bank concerned and are often termed as micro or bank specific determinants of profitability. The external determinants are systematic forces that reflect the economic environment. The literature provides mixed evidence on the impact of liquidity on profitability. Revell (1979) studied the relationship between bank profitability and inflation. He noted that the effect of inflation on bank profitability depends on whether bank wages and other operating expenses increased at a faster pace than inflation. Chippa and Sagar (1981) discussed the variations in the level of banking development in Eighteen States in 1977 and studied its relationship with other social, economic and infrastructural variables. The analysis revealed that literacy rate followed by the infrastructural development emerged as the most dominant variables influencing the level of banking development. Angadi (1983) measured the extent of concentration of priority sector advances in general and agriculture advances in particular in selected States in India. The analysis revealed that the degree of concentration of both priority sector advances and agricultural advances in the selected States had reduced in 1979 as compared to 1969-70. Bhattacharya (1986) analysed the impact of branch expansion on the deposit mobilization in the different states of India. The broad conclusion drawn by the researcher was that all the four types of deposits were satisfactorily responsive to branch expansion in Maharashtra, Uttar Pradesh, Karnataka, Tamil Nadu, Andhra Pradesh, Gujarat, Punjab, Kerala and New Delhi. However in the states like Himachal Pradesh, Jammu & Kashmir, Assam, Orissa and Bihar, the 4 extent of branch expansion was very small in relation to the above mentioned states. Kumar and others (1987) made an attempt to study the expansion of commercial banking facilities and extent of disparity in agriculture financed by the commercial banks in various states of India. The analysis revealed that the expansion of banking facilities had been extended more rapidly comparatively in rural areas as compared to Semi-Urban areas and Urban areas. Bal Krishna and Sooden (1991) made an attempt to ascertain the extent of inter-state disparities with respect to commercial banking services in rural India during 1975 to 1985

3. RESEARCH METHODOLOGY

A. Research Statement

The following research statement is tested:
"Financial performance of Regional Rural Banks in India before and after Amalgamation"

B. Objectives of the Study

The objectives of the study are as follows:-

To analyze the financial performance of Regional Rural Banks in India before and after amalgamation

To understand the working of Regional Rural Banks in India

C. Hypothesis

• **Null Hypothesis:**

The following null hypothesis is framed: H0: There is no significant difference in financial performance of RRBs in India after amalgamation.

•**Alternative hypothesis:** The alternative hypothesis is framed: H1: There is significant difference in financial performance of RRBs in India after amalgamation.

D. Scope of the study

The scope of present study is confined to Regional Rural Banks in India. The study mainly involves the financial performance of Regional Rural Banks in India before and after amalgamation. Similar studies on this line may be conducted for other banks in India and outside India.

E. Data Collection

The study is based on secondary data which is collected from secondary sources via-various journals, magazine, newspapers and annual reports and websites of regional rural banks and through various search engines.

F. Sample Size

For the present study, all the regional rural banks in India were taken for analysis. The process of amalgamation initiated in 2005, is now nearing completion. As a result of amalgamation process, the number of RRBs in the country declined from 196 to 96 at the end of March 2007 and further to 88 at the end of June 2008 and 84 as on January 2010 G. Tools and Techniques

G. Tools and Techniques

The following tools and techniques are used for the present study

Ratio analysis Percentage Mean Standard Deviation T-test Anova

H. Limitations of the study

The present study is undertaken to maximize objectivity and minimize the errors. However, there are certain limitations of the study which are to be taken into consideration for the present work.

1. The study fully depends on financial data collected from the published financial statements of Banks.
2. This study incorporates all the limitations that are inherent in the financial statements.
3. Financial statements reflects the book value and the management might have window dressed or manipulated the values

4. DATA ANALYSIS

- 15% of RRBs were loss making RRBs in 2001-02 but the numbers decreased to 7% in 2008-09. This proves that amalgamation has been beneficial to RRBs in reducing their losses.

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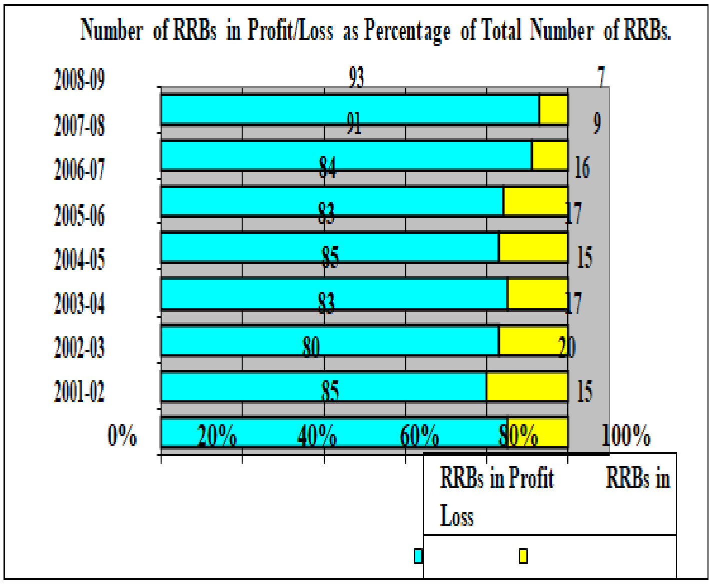

- Also Net NPA of RRBs have reduced from 11.53% in 2001-02 to 4.84% in 2004-05 but after amalgamation the Net NPA's have further reduced from 3.92% to 1.76%. Thus amalgamation has been beneficial for RRBs to reduce their Net NPA.

5. FUNCTIONS OF REGIONAL RURAL BANKS:

The main functions (or objectives) of-the RRBs are:

1. To grant loans and advances to the weaker sections of the rural population, especially to the small and marginal farmers, agricultural labourers, artisans and small entrepreneurs who are engaged in agriculture, trade, commerce, industry and other productive activities.
2. To grant loans and advances to cooperative societies, including marketing societies, agricultural processing societies, cooperative farming societies, primary agricultural credit societies or farmers' service societies for agricultural purposes.
3. To take banking services to the doorsteps of the rural masses, particularly in hitherto unbanked rural areas.
4. To mobilize rural savings by accepting deposits and channelize them for productive activities in the rural areas.
5. To create supplementary channel for flow of credit from the urban money market to the rural areas through refinance.
6. To generate employment opportunities in rural areas.
7. To bring down the cost of supplying credit in rural areas.

In recent years, the RRBs have been permitted to extend advances for purchase of durable consumer goods and loans for various purposes against the security of gold ornaments, National Savings Certificates, Indira Vikas Patras to both target and non-target groups up to 10 per cent of their fresh lending within the over ceiling of 60 per cent of fresh loans to non-target group lending.

They have also been allowed to issue guarantees on behalf of their customers without any limitation 100 per cent cash margin and up to Rs.20 lakh on Rs.40 lakhs cash margin plus collateral security of more than 50 per cent.

The limits for purchase of demand drafts and cheque have been raised per customer and per branch to Rs.25,000 and Rs.1 lakh respectively. The RRBs can issue travellers' cheques as agents of their sponsor banks and also provide locker facilities.

The RRBs can invest their surpluses in UTI listed schemes, fixed deposits of profit making term lending institutions, bonds of nationalised banks and other public sector undertakings, non-convertible debentures of blue chip companies and in credit portfolios of their sponsor banks-subject to a maximum of 15 per cent of their fresh lending during the year. Effective 8 January, 1997, RRBs have been allowed to invest in corporate shares and debentures and units of mutual funds.

6. PROBLEMS OF REGIONAL RURAL BANKS:

Despite the important role played by RRBs in providing credit to the weaker sections of society in rural areas, they are faced with serious problems which have led critics to question their very existence. The Dantwala Committee (1978), the Kelkar Committee (1986) and the Khusro Committee (1989) have pointed towards some of the weaknesses in the working of RRBs which are as follows:

6.1 Haphazard Branch Expansion:

A large network of branches has been opened at a fast pace which has not contributed to substantial increase in business. It has added to overhead costs without contributing to profits. Moreover, major variations persist among States in the coverage of districts/ branches by the RRBs. In some States, backward areas still remain uncovered by these banks.

6.2 Defective Recruitment Policy:

Being rural oriented, the RRBs are expected to recruit staff locally. With the transfer of recruitments in RRBs to the Banking Service Recruitment Boards, the candidates outside the area of operations of RRBs are also made eligible for recruitment into RRBs

6.3 Rigid Norms:

The norms laid down for the selection of beneficiaries in RRBs are rigid and based on an all India income level. The poverty line available in Haryana is not the poverty line obtained in Andhra Pradesh. The village, its people, their occupations and economic status differ widely in Andhra Pradesh with that of All India average. But to apply the same norms to all the States leave out many persons who are in need of credit from the RRBs.

6.4 Weak Capital Base:

The capital base of each RRB is weak. Initially, the issued capital was Rs.50 lakh which has been raised to Rs.75 lakh and Rs.1 crore in the case of selected RRBs. But the State Governments failed to contribute their share. In view of its enormous credit obligation in rural areas, this limit is on the lower side.

6.5 Constraints in Deposit Mobilisation:

As the RRBs supply credit only to the weaker sections of the rural population, they have been unable to mobilise sufficient deposits. The weaker sections who are the main beneficiaries are poor and do not save so much as to deposit in the RRBs. The middle classes and the rural elite are not interested to deposit their saving in the RRBs. They deposit them in commercial banks from whom they get credit facilities.

6.6 Erosion of Profitability:

The RRBs have not been able to operate on a viable basis. The major factors which have contributed to the erosion of their profitability have been their lending exclusively to the weaker sections, low interest margins and high operating cost involved in handling small loans. During 1999-2000 there were 33 loss making RRBs which incurred a net loss of Rs.109 crores.

6.7 Poor Recoveries:

The recover of loans due has been very poor. The estimate of the Khusro Committee revealed that as on June 1986, the recovery of RRBs was 49 per cent. During 1999, the recovery level was below 30 per cent. The main factors have been willful defaults, misuse of loans, lack of follow-up, wrong identification of borrowers, extension of benami loans, staff agitations, etc.

6.8 Defective Credit Deployment:

In many districts, the credit deployment has not been proper., The loaning activities are mainly confined to crop loans and the schemes sponsored by the State Governments. The schematic approach towards lending is lacking in many cases.

6.9 High Loan Transaction Cost:
With parity in pay scales between the RRBs and commercial banks, the loan transaction costs in RRBs are many times higher than in rural branches of commercial banks.

7. SUGGESTIONS TO IMPROVE THE WORKING OF RRBs:

To improve the working of the RRBs, the Dantawala Committee (1978), the Kelkar Committee (1986) and the Khusro Committee (1989) have made a number of suggestions. Some of these are enumerated below:

1. To improve the viability of RRBs, the Khusro Committee recommended that the RRBs should be merged with the commercial banks. The merger would solve the problems of accumulated losses, of insolvency, and of the in-built non-viability of the majority of RRBs.

2. In order to strengthen the capital structure of RRBs, the Kelkar Committee recommended the raising of issued capital of RRBs from Rs.25 lakhs to Rs.100 lakhs and the authorised capital from Rs.1crores to Rs.5 crore.

3. As the very purpose of establishing RRBs is to transfer funds from urban money market to rural centres, the State Governments should permit the Panchayats and other quasi-government bodies functioning in rural areas to keep their funds with the RRB branches functioning within their area of operations.

4. The State Governments should either re-organise agricultural credit societies or establish new Farmers' Service Societies through which RRBs can provide production credit on a large scale and thereby the cost of servicing will be reduced considerably.

5. The sponsor banks should play a more active role in advising and helping their RRBs in managing their funds, in appraising loan schemes, in making proper end-use of credit, and in providing staff for internal audit of RRBs.

These RRBs drew up their Development Action Plans in consultation with NABARD and sponsor banks and Mou were entered between them and sponsor banks. The Government of India contributed Rs.180 crores as its share of 50 per cent during 1994-95. During 1995-96.

8. CONCLUSIONS

RRBs are well positioned to play a major role in financial inclusion particularly in areas with high rates of financial exclusion. RRBs were originally created to cater to neglected sections as they were expected to have sound financial management combined with local feeling and familiarity. RRBs should concentrate on asset quality and earnings. With the increasing competition among banks to meet customer expectations, banks should offer a broader range of deposits, Investments and credit products through diverse distribution channels including ATMs, telephone, and internet. The RRB staff is required locally and their postings or transfers are within the banks area of operation which is ordinarily districts or two. The need for maintaining the local ethos makes it imperative that the emoluments and services conditions of the RRB staff should be in line with those of State Government staff in comparable cadres who constitute bulk of the salaried people in the area and with whom the former have to establish a close rapport for their day to day work. Therefore, the emoluments of the staff should be continued to be determined as per the state government scales. It is obvious that the terms of service and facilities available to the government staff may differ from state to state. RRBs could not adhere to their branch expansion programmes for lack of adequate technical assistance in project formulation by RRBs. Facilities for recruitment and training and technical assistance should continue to be provided by the sponsor banks, on the same terms for a period of 10 years for each RRB.

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