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A Study on Analysis of Operating and Financial Performance of Regional Rural Banks in Indian context

Ravikumar Kuranal[1], Dr. Ravikumar K[2]

[1]Assistant Professor, Department of Commerce, S.V.M Arts, Science and Commerce College, Ilkal
Research Scholar, Department of Commerce, SJB CMS, Research Centre, Bengaluru - 560060
Email: kurnal.ravi@gmail.com

[2]Professor, Department of Commerce, SJB CMS, Research Centre, Bengaluru – 560060
Email: ravikumar175719@gmail.com

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ABSTRACT:

The development of India's economy and rural sector depends heavily on agriculture, so it is essential to develop strategies for increasing income and creating jobs in rural areas, creating programs to reduce poverty in unbanked rural areas, and creating the right institutions and mechanisms to meet the credit needs of the rural sector. A significant step in this direction was the establishment of Regional Rural Banks (RRBs) in the middle of the 1970s. The RRBs are specialist rural financial institutions that provide small and marginal farmers, agricultural workers, artisans, and small business owners with the credit they need to grow their businesses.However, there were also commercial and cooperative banks to meet the financial needs of the rural sector. While the commercial banks' efforts to increase agricultural credit were limited by their concentration on profitability, the cooperative banks' efforts were also hindered by a number of financial difficulties. Even yet, over time, Regional Rural Banks have been able to increase their clientele, their revenue, and their ability to provide credit to the underprivileged. However, in the current environment, a number of flaws have also surfaced that have weakened their profitability and viability, such as past due, loan recovery, nonperforming assets, etc. Regional Rural Banks play a significant role in the delivery of credit in rural regions by offering credit facilities to the economically weaker segment of the population for the growth of trade, industry, and agriculture. In India's agricultural and rural development, regional rural banks are essential. Through their extensive network, the RRBS have a greater reach in India's rural areas. The financial stability of the rural areas in India is a key factor in the success of rural credit. RRBs are a crucial source of finance for rural areas, and they are in charge of providing different sorts of agriculture credit in rural areas with the loans they require. The majority of regional rural banks are currently dealing with issues including past due, recovery, non-performing assets, and other issues. The financial performance of RRBs in India must therefore be studied. Even after 65 years of independence, 65% of the population still resides in rural areas. The strength of the rural sector is crucial to the growth of the rural economy. The Indian government has initiated and carried out a number of policy measures. However, poverty, a lack of access to clean water and sanitary services, subpar housing, high rates of illiteracy, and other comparable economic and social disadvantages continue to plague rural India. One of the fundamental engines of economic expansion is the banking sector. Given that it is a crucial link in numerous socioeconomic operations, it must be stable. The GOI established the Regional Rural Banks (RRBs) in 1975 in accordance with the requirements of the ordinance proclaimed on the 26th September 1975 with a view to thriving the rural economy. The share capital of RRBs was financed to a percentage of 50% by the Government of India, 15% by the relevant State Government, and 35% by the bank that sponsored the RRB. The RRBs can only operate in certain districts in a State that have been notified. The RRBs generally collect deposits from rural and semi-urban areas and lend money largely to small and marginal farmers, agricultural laborers, rural craftsmen, and other priority sector sectors. RRBs have more access to rural areas and are crucial to India's development of its rural areas and agriculture industry. The primary goals underlying the establishment of this sort of dynamic institution in India were to create a connection between rural households and banks, especially in banking-deficient areas. Additionally, to promote rural savings, create job possibilities, and offer more affordable loans to rural India's marginalized population.

Keywords: Financial Performance, Regional Rural Banks, Cooperative Banks, Policy Measures, Loan Recovery, Nonperforming Assets

Introduction:

The Regional Rural Banks have been a part of the Indian financial system for almost 36 years. To address the excessive demand for institutional credit in rural areas, particularly among the economically and socially vulnerable parts, Regional Rural Banks (RRBs) were established. The Government of India ultimately established Regional Rural Banks as a separate institution primarily for rural credit on the basis of the recommendations of the Working Group headed by M. Narasimham, as per the Banking Commission's (1972) recommendation to establish an alternative institution for rural credit. The primary goal of the founding of RRBs in India was to guarantee adequate institutional credit for rural sectors such as agriculture and other rural industries. The majority of the people who receive loans and advances from regional rural banks (RRBs) are rural craftsmen, small and marginal farmers, and agricultural laborers. Rural development involves not just the expansion of rural areas but also the transformation of rural populations into modern, self-sufficient small towns. The goal of rural development in the country is to improve the socioeconomic living conditions for rural residents of India while preserving their rich cultural heritage. In order to foster the nation's overall economic development, the government is working to meet higher targets for rural output, employment, and living standards. Along with the implementation of programs aimed at enhancing rural employment, agricultural productivity, and rural industrialization, this entails the establishment of essential infrastructure and facilities including hospitals, schools, and transportation options. Due to high interest rates and limited simple access to credit, India's rural population suffers from heavy debt and is vulnerable to abuse in the credit market. Rural households require loans to finance agricultural investments and level out seasonal income swings. Rural households usually rely on credit to pay for other consumer needs like schooling, food, housing, household activities, etc. because cash flows and savings are typically low for the majority of households in rural areas. In order to avoid falling into debt traps, which are frequent in rural India, rural households need access to financial institutions that can offer them credit at rates and terms that are more favorable than those offered by traditional moneylenders. Since their establishment in 1975 as unique institutions acting as a catalyst for the development of rural areas, the Regional Rural Banks have gained in significance. They have been instrumental in fostering a culture of banking among rural populations and providing financial support to the weaker members of the society. The goal of regional rural banks was to boost the rural economy by giving loans and other resources, especially to small and marginal farmers, agricultural workers, artisans, and small business owners. RRBs, along with commercial and cooperative banks, were given a crucial role to play in the delivery of agriculture and rural finance due to their status as local level organizations. The primary goal of RRBs from the start was to progress the nation by improving public funding for the more vulnerable segment of the population. In order to modernize the province economy, the development of country credit focuses on offering account and various offices in the improvement of agriculture and related initiatives. These organizations serve as an addition to the existing institutional credit foundation and also serve to lessen the cooperation of sporadic credit offices, especially dishonest cash loan specialists. The Regional Rural Banks have developed into a crucial component of the provincial credit delivery system and are considering important steps in completing banking services, preparing the rural reserve funds of the more vulnerable areas of the towns, even in small amounts, and pounding in them for assisting creation activities through renegotiating. Accordingly, this inquiry makes an effort to evaluate the way regional rural banks are presented in India and to provide suggestions for how to make it better.

Regional Rural Banks (RRBs) In India-An Overview:

Indian rural residents, including small and marginal farmers, landless agricultural laborers, craftsmen, and socially and economically underprivileged castes and groups, have been taken advantage of by the informal sector under the pretense of providing finance. The conventional and informal financial institutions and organizations that service India's rural populations' credit needs make up the rural credit market. The terms and conditions of such loans have given rise to a complex system of intimidation of both economic and noneconomic conditions in the rural population of India. The informal sector advances loans at extraordinarily high rates of interest. Rural credit markets are unreliable and disjointed, and the total amount of formal credit available is insufficient. Furthermore, there have been disparities in the allocation of formal sector credit, notably in rural areas with regard to geography, class, caste, and gender. India's Regional Rural Banks have a long history that began in 1975. The Narasimham committee was responsible for the idea of India's Regional Rural Banks. The committee believed that rural banks with a regional focus were necessary in order to meet the needs and concerns of India's rural residents.

In order to guarantee adequate institutional credit for agriculture and other rural sectors, Regional Rural Banks were founded in accordance with the requirements of an Ordinance published on September 26, 1975, and the RRB Act, 1975. Small and marginal farmers, agricultural laborers, and rural artisans are the main recipients of loans and advances from RRBs, which mobilize financial resources from rural and semi-urban areas. The Reserve Bank of India defines a rural region as a locality with a population of fewer than 10,000 for the purposes of classifying bank branches. Government of India, the relevant State Government, and Sponsor Banks jointly hold RRBs; they each own a piece of the RRB's issued capital in the amounts of 50%, 15%, and 35%, respectively. With support from several commercial banks, the first five RRBs were established in five States: Haryana, West Bengal, Rajasthan, with one in each, and two in Uttar Pradesh. The 11 districts of these five states were covered by these banks. Following are the names of the first five Regional Rural Banks: Prathama Bank and Gorakhpur Kshetriya Gramin Bank in Uttar Pradesh; Haryana Krishi Gramin Bank in Haryana; Gour Gramin Bank in West Bengal; and Jaipur-Nagpur Anchalik Gramin Bank in Rajasthan.

Restructuring Strategies of Regional Rural Banks:

The financial sustainability of RRBs has occasionally caught the attention of policymakers. The Committee to Review Arrangements for Institutional Credit for Agriculture and Rural Development (CRAFICARD), in fact, began addressing the question of the RRBs' financial viability as early as 1981. "The loss experienced by an RRB should be made whole annually by the shareholders in the same proportion of their shareholdings," the CRAFICARD advised. Despite the fact that this suggestion was rejected, the owners contributed money in accordance with their shareholdings as part of a recapitalization plan. Several committees have since released various recommendations to improve the RRBs' lack of financial viability. For instance, in the interest of economic viability, the Working Group on RRBs (Kelkar Committee) advised in 1984 that small and unprofitable RRBs be combined. Five years later, in a similar spirit, the Agricultural Credit Review Committee (Khusro Committee), 1989 noted that the only solution was to merge the RRBs with the sponsor banks since "the faults of RRBs are endemic to the system and non-viability is built into it." Only independently operating financial institutions might successfully serve the poorer segments of society. 49 RRBs were chosen for thorough reorganization by the 1994 Committee on Restructuring of RRBs (Bhandari Committee). It suggested giving the Boards of RRBs more authority to make decisions about business development and personnel issues. The Committee on Revamping of RRBs, 1996 raised the possibility of liquidation once more (Basu Committee).

Very weak RRBs should be treated independently and the prospect of their liquidation should be acknowledged, according to the Expert Group on RRBs (Thingalaya Committee) in 1997. They might combine with nearby RRBs. The Sponsor Bank should ensure that RRBs have the essential autonomy in their credit and other portfolio management systems, according to the Expert Committee on Rural Credit, 2001 (Vyas Committee I). The Chalapathy Rao Committee, a later committee headed by Chalapathy Rao, made the recommendation in 2003 that the RRB system as a whole be merged while preserving the benefits of these institutions' regional identities. During the process, some sponsor banks can be gradually phased out. In addition to commercial banks, the sponsoring institutions may also include other authorized financial institutions. The Group of CMDs of Selected Public Sector Banks, 2004 (Purwar Committee) suggested the consolidation of RRBs into six commercial banks, one for each of the six major geographic areas: the Northern, Southern, Eastern, Western, Central, and North-Eastern. Thus, one discovers that a variety of options have been put forth by various committees that have looked into the issue of financial viability and restructuring strategies for the RRBs, ranging from vertical merger (with sponsor banks), horizontal merger (among RRBs operating in a particular region), to liquidation.

Review of literature:

RRBs are scheduled commercial banks with a commercial orientation, despite the fact that they operate with a rural concentration. The literature examining factors impacting the performance of banks, beginning with the key work of Haslem (1968), recognizes two major types of elements, namely, internal factors and factors external to the bank. The internal factors, which are frequently referred to as micro or bank-specific factors of profitability, come from the balance sheets and/or profit and loss accounts of the relevant bank. The external determinants are systemic dynamics that represent the economic environment, which influences how well financial institutions operate and perform. In the literature, a number of explanatory factors for both internal and external determinants have been proposed. Variables including size and capital [Akhavein et al. (1997), Demirguc-Kunt and Maksimovic (1998), Short (1979), Haslem (1968), Short (1979), Bourke (1989), Molyneux and Thornton (1992), Bikker and Hu (2002), and Goddard et al. (2004)] are frequently used as internal determinants. Given the nature of the banking industry, risk management is essential for a bank's financial stability. Risk management is a reflection of a bank's quality of assets and accessibility to liquidity. Banks may want a more diversified portfolio in times of uncertainty and economic slowdown to prevent adverse selection and may also increase their liquid holdings to lower risk. Both credit risk and liquidity risk are significant in this situation. The literature offers conflicting information regarding how liquidity affects profitability. Although Molyneux and Thornton (1992) discovered a weak and negative correlation between profitability and liquidity, In contrast, Bourke (1989) reports the opposite outcome. The variable elasticity of loan demand in the study samples could be one cause for the contradictory results (Guru, Staunton and Balashanmugam, 2004).Profitability has been shown to be negatively impacted by credit risk (Miller and Noulas, 1997). This conclusion can be explained by taking into account the fact that the accumulation of unpaid loans increases as financial institutions' exposure to high-risk loans increases, suggesting that these loan losses have resulted in poorer returns for many commercial banks (Athanasoglou, Brissimis and Delis, 2005). Haslam (1968), capital and liquidity ratios, the credit-deposit ratio, and loan loss expenses are a few other internal factors that can be discovered in the literature [Short (1979); Bell and Murphy (1969); Kwast and Rose (1982)]. Another crucial factor in determining a bank's profitability is expense management, which is a correlate of efficient management. The idea that an expense-related variable should be included in the cost portion of a typical microeconomic profit function has been extensively studied in the literature. According to Bourke (1989) and Molyneux and Thornton (1992), more effective management and profitability go hand in hand in this situation.The literature makes a distinction between control variables that characterize the macroeconomic environment, such as inflation, interest rates, and cyclical output, and variables that indicate market characteristics when it comes to the external factors affecting bank profitability. The latter speak of ownership status, industry scale, and market concentration. Regulation [Jordan (1972); Edwards (1977); Tucillo (1973), bank size and economies of scale [Benston, Hanweck and Humphrey (1982); Short (1979), competition [Phillips (1964); Tschoegl (!982)], concentration [Rhoades (1977); Schuster (1984), market growth [Short (1979), interest rates as a proxy for capital scarcity, and government ownership are some of the external determinants that are empirical (Short, 1979). The rate of inflation, the long-term interest rate, and/or the growth rate of the money supply are the three macroeconomic control variables that are most frequently utilized. The subject of the connection between bank profitability and inflation was first raised by Revell in 1979. He points out that whether wages and other running costs at banks rise more quickly than inflation has an impact on how profitable banks are affected by inflation. In a similar spirit, Perry (1992) argues that whether inflation expectations are properly predicted determines how much inflation affects bank profitability. Another hotly contested and frequently discussed topic in the literature is the impact of a bank's ownership position on its profitability. However, the empirical data supporting the claim that privately owned institutions are more profitable is not entirely consistent. For instance, Barth et al. (2004) assert that government ownership of banks is indeed negatively connected with bank efficiency, but Short (1979) provides cross-country evidence of a strong negative association between government ownership and bank profitability. Furthermore, ownership status is not relevant in explaining profitability, according to Bourke (1989) and Molyneux and Thornton (1992). While many of the aforementioned criteria would be pertinent, it would be beneficial to look at the literature that has only addressed RRBs.The study, titled "Regional Rural Bank and Financial Inclusion," revealed that RRBs significantly impacted financial inclusion and opened almost 2,500 additional branches, many of which were in unbanked areas, in order to meet the financial inclusion targets set by the RBI. This study made the case that RRB performance has improved as a result of special consideration being given to the requirement for technical adaptation and the functioning of the correspondent's outlet Ahamed Lebbe Abdul Rauf (2016).The study, titled "Regional Rural Bank and Financial Inclusion," revealed that RRBs significantly impacted financial inclusion and opened almost 2,500 additional branches, many of which were in unbanked areas, in order to meet the financial inclusion targets set by the RBI. 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The establishment of various areas to specific Regional Rural Banks has led them to the conclusion that the establishment of Regional Rural Banks for the development of rural economy by providing financial assistance to agriculture, trade, commerce, small and household industry through credit and advances are being met Dhanraj N and Saikumar R (2018).

Structure and functions of the regional rural banks:

The Regional Rural Banks (RRBs) were created with the purpose of giving small and marginal farmers, agricultural workers, craftsmen, and small business owners in rural areas access to loans and other amenities. When any sponsor bank makes such a request, the RRB Act, 1986 gives the Central Government the authority to create one or more RRBs in a State or Union Territory. By subscribing to its share capital, aiding in its establishment, helping with the hiring and training of its cadre, and generally providing the management and financial assistance requested by the RRBs, the sponsor bank helps the RRBs in a variety of ways. The RRBs operate within the local restrictions set forth by official notification. It may have branches wherever the government notifies it to.

Organization structure of the RRB’s:

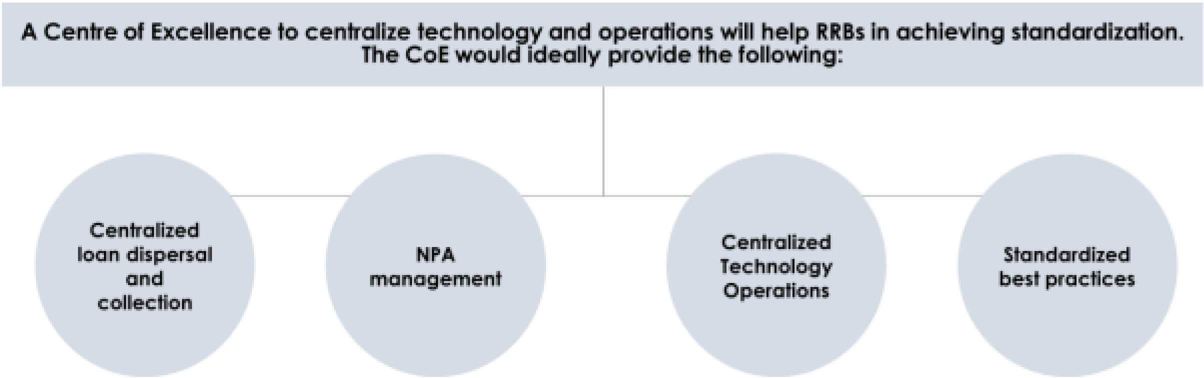
An RRB's issued capital is set at Rs. 2 lakhs, whereas its authorized capital is Rs. 1 crore. The central government is required to subscribe for 50% of the issued capital, the concerned state government for 15%, and the sponsoring bank for the remaining 35%. A Board of Directors that includes a Chairman, three directors to be nominated by the Central Government, no more than two directors to be submitted by the concerned State Government, and no more than three directors to be recommended by the sponsoring bank, manages and directs the operations of RRBs. The Central Government appoints the chairman, who serves terms of no more than five years.

Credit Deposits Ratio (CDR):

The credit deposit ratio measures the proportion of deposits that a bank lends against. The CDR shows how much of a bank's core funds are being used for lending, which is a bank's primary business. This ratio provides the first clue as to a bank's health. A larger ratio denotes a greater reliance on deposits for lending, and the opposite is also true. The current credit-deposit ratio for the banking industry is 75%. By giving targeted poor people access to loans and other facilities for the development of agriculture, trade, and other productive activities, the RRBs were designed to boost the rural economy.

Centre of Excellence:

To achieve standardization, RRBs might create a center of excellence (CoE) to centralize technology and operations. The CoE would be at the level of the sponsor bank and should preferably offer the following:



Above image showing Centre of excellence to centralize technology and operations to help RRB's in achieving standardization

- **Centralized Loan Processing:** It will make it possible for sponsor banks to streamline the sanctioning procedure and lower RRB pricing. NABARD can assist sponsor banks in setting up a centralized unit for loan processing and sanctioning, allowing all data to come from a single source.
- **NPA Management:** For the management of NPAs, NABARD can assist in locating potential EWS (early warning system) partnerships and procedures. The same will be implemented by sponsor banks for their RRBs.
- **Technology:** For tech collaborations and the establishment of APIs, NABARD can develop standard operating procedures. To increase uniformity, NABARD can assist with consolidated technology procurement for all RRBs. Onboarding and other tech-related tasks should be centrally outsourced for increased efficiency.
- **Best Practices:** NABARD can produce white papers, studies, and procedures on best practices that sponsor banks can use.

Conclusion:

The word "performance" can mean several things depending on the setting and uses. Any evaluation of rural regional banks' performance may become meaningful with its underlying goals if it takes into account the variety of operations they carry out. In the current study, an effort has been made to evaluate the performance of Regional Rural Banks (RRBs) using a set of established factors, including the RRBs' development pattern, credit distribution, and geographic dispersion. Thousands of commercial bank and cooperative bank branches operated in the rural parts of India prior to the establishment of RRBs.The liberation of rural populations from poverty, unemployment, and other socioeconomic backwardness is essential to the actual progress of the Indian economy. Given that RRBs are a crucial component of India's rural credit structure, this discovery could be of great assistance to rural banking institutions and policymakers in creating and defining the ideal loan structure.RRB has made commendable efforts in deposit mobilization, rural development, branch expansion, and credit deployment in rural areas with the lowest income levels. RRB is successful in achieving its goals, which include bringing banking to rural households' doorsteps, especially in banking-deprived rural areas, providing accessible, affordable credit to vulnerable rural populations that depend on private lenders, encouraging rural savings for productive activities, creating jobs in rural areas, and lowering the cost of credit distribution in rural areas. RRB thus offers the most robust banking network. Government should focus on providing high-quality, secure, and quick banking services in order to make Rural Banks profitable.

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