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The Role and Performance of Rural Banks in India

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Abstract: In the Indian financial sector, the role of the rural banks is important but not apparently pre-eminent. The contribution of the commercial banks to the rural / semi-urban banking network is far higher (at 38% of the total) than the 28 per cent contribution of rural banks to the total of 87,000 bank branches in India. Despite the apparent importance of commercial banks even in the rural areas however they are neither able nor willing to serve the poorest sections of the population. By comparison, in the credit categories of direct relevance to financial inclusion, RRBs hold 26.2 per cent of agricultural credit accounts and as many as 55.0 per cent of all artisan/tiny industry loan accounts. This amounts to much lower proportions of overall credit available under these categories - just 10.9 per cent and 11.0 per cent respectively -since RRB loan sizes average just Rs 25,000 and Rs13,000 for these two categories, much smaller than those offered by the commercial banks. Yet, it is precisely this fact that shows the importance of the rural banks for otherwise financially excluded sections of the population.

Low income families have a much lower absolute and proportionate need for credit than better off sections of the population that are, in any case, better able to access the commercial banks. Similar data for cooperatives is not available but with an estimated 130 million members the average loan outstanding with cooperatives amounts to just over Rs 9,000 per member, emphasizing their suitability to the needs of low income families. Taken together, the rural banks record a credit-deposit ratio of 81.7 per cent in March 2007, somewhat higher than the average of 76.1 per cent for the entire banking system. Rural banks have, for a number of years, been regarded as the step-child of the banking system in India. Both types of rural banks have been subject to extensive interference in their operations, being seen as a conduit for government subsidies and a means of political patronage. It is not surprising, therefore, that both the cooperative credit system and RRBs have encountered serious financial difficulties and were virtually crippled in the early 1990s, needing a substantial injection of capital at that time. The performance of such banks in recent years has been somewhat better though.

Thus, 85 per cent of the RRBs and around 75 per cent of cooperative banks are now profitable on a year-on-year basis. While all the RRBs taken together now regularly register a profit, the DCCB performance is erratic with significant numbers slipping into losses before recovering from one year to the next. In March 2003, as many as 144 out of 367 DCBs were reported to have completely eroded their net worth and to have eroded Rs3,100 crore worth of deposits as well.

The RRBs, over the years have made impressive strides on various business indicators. For instance, deposits of RRBs have grown by 18 times and advances by 13 times between 1980 and 1990. Between 1990 and 2004, deposits and advances grew by 14 times and 7 times, respectively. Between the year 2000 and 2004, loans disbursed by RRBs more than doubled reflecting the efforts taken by the banks to improve credit flow to the rural sector. The average per branch advances also increased from Rs.25 lakh in March 1990 to Rs.154 lakh in March 2003. When one considers the deployment of credit relative to the mobilization of resources, the credit deposit (C-D) ratio of RRBs were more than 100 per cent during the first decade of their operations up to 1987.

Though the C-D ratio subsequently became lower, of late, it has shown an improvement and went up from around 39 per cent in March 2000 to 44.5 per cent in March 2007.

Key Factors of Performance of RRBs:

1. Limited area of operation: With a narrow range of business activities and small base of clients leading to high covariant risk.
2. Focus on small customers: such as small and marginal farmers, small transport operators, small and micro enterprises and self help groups with limited credit requirements making it impossible to earn bulk incomes from larger, high income
3. borrowers to cross-subsidies lending to the main customer group.
4. Perception as an instrument of social policy: Without viability considerations while there was pressure to improve financial performance, resulting in uneven growth
5. A capital base that is too low for their business volume: Resulting in a serious prudential hazard whereby hundreds of crore rupees of deposits were underpinned by just Rs1 crore of capital.
6. Small organizational structure and limited financial assets: Come in the way of garnering a larger share of the rural financial market by making it difficult to provide a full range of financial services, thereby discouraging large depositors and borrowers.
7. High loan delinquencies: Resulting from their use for directed lending by the State
8. High cost of servicing numerous small accounts: While the interest cost of funds from NABARD and sponsor banks was higher than market rates but rates of interest charged to customers had to be kept in line with the competing commercial banks.
9. Poor financial skills: Resulting in an inefficient allocation of resources and parking of large amounts with sponsor banks.

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10. Conflict of business interests with sponsor banks: that operates in the same areas but has been responsible for the financial and business initiatives of their RRBs.
11. Lack of professionalism in management: As senior managers (including Chairmen) are appointed out of the serving officers of the sponsor bank which results often in the reference of small matters to the sponsor with consequential delays in decision making.
12. Lack of skilled staff: Resulting from inappropriate training and lack of exposure to new products and development activities for catering to the changing requirements of the rural sector. An ageing staff profile resulting from the ban on recruitments has constrained efficiency in operations and uniform norms and policies across the country ignoring local issues and conditions have lowered staff morale reducing
13. involvement in development tasks.
14. Inappropriate wage structure: Which was brought in line with the higher wages of the commercial banks even as RRBs were required to retain their rural flavor to identify with the rural population, yet they were required to adhere to an
15 Administered interest rate regime: That depressed rates since they were lending to the "weaker sections" and yet were required to pay a slightly higher rate than commercial banks on deposits.

RRBs: Financial Sector Reforms: Several changes have taken place in the focus and operation of the Regional Rural Banks in the wake of financial sector reforms in India and various measures have been taken by the Government to improve the commercial viability of RRBs since 1994-95. So it has been considered appropriate to study the performance after amalgamation which took place in the year 2006.A study of the efficiency and its performance of the RRB are particularly important in the Indian context.

In the wake of introduction of financial sector reforms in 1991-92, the commercial viability of RRBs emerged as the most crucial factor in deciding about their desired role due to their limited business flexibility with hardly any scope of expansion /diversification, smaller size of loans with higher exposure to risk-prone advances and professional efficiency in financial deployment. To strengthen RRBs and improve their performance many initiatives have been taken by the Government of India and the Reserve Bank of India. As part of the comprehensive restructuring programme, recapitalization of RRBs was initiated in the year 1994-95. The process continued till 1990-00 and covered 187 RRBs with aggregate financial support of Rs.2188.44 crore from the shareholders, viz., Government of India, State Governments and sponsor Banks in the ratio of 50:15:35.

Further, the branch licensing policy for RRBs has been liberalized. Under the new norms, empowered committees at the regional offices of RBI clear RRB application to open new branches. The branches of RRBs may undertake government business including conducting foreign exchange business with the prior approval of the concerned Government authority and RBI. These banks have also been allowed to open extension counters at the premises of the institutions of which they are principal bankers after obtaining license from the concerned regional office of the RBI. The RRBs need not obtain permission of RBI for the installation of ATMs at the branches and extension counters for which they hold licenses issued by RBI.

They are also permitted to open off-site ATMs after assessing the cost and benefit. As against the earlier policy of opening a large number of branches in far flung rural areas, RRBs have been permitted to merge/close down their unviable branches and the branch licensing policy for RRBs is almost at par with that for commercial banks. Now RRBs compete with the commercial banks in rural credit market of India. RRBs give loans for agriculture and rural development while commercial banks also serve needs of commerce and industry in rural areas.

In 2005-06, the Government of India initiated the process of structural consolidation of RRBs by amalgamating RRBs sponsored by the same bank within a State as per the recommendations of the Vyas Committee. The amalgamated RRBs were expected to provide better customer service due to better infrastructure, computerization of branches, pooling of experienced work force, common publicity, marketing efforts etc., and also derive the benefits of a large area of operation, enhanced credit exposure limits and more diverse banking activities.

As a result of the amalgamation, the number of RRBs was reduced from 196 to 86 as on 31st March, 2009. Thus, under the amalgamation process, 145 RRBs have been amalgamated to form 45 new RRBs.

Reducing Cost of Rural Credit: A different dispensation under CRR and SLR would help in making available more resources for rural credit deployment. The rate of interest paid on CRR balances held by these rural institutions might also be marginally above what is paid to commercial banks. Similarly, the Central Government and all State governments need to park their rural developmental funds with RRB to ensure cheaper flow of demand deposits. Regulation with respect to banking has been designed for delivery in urban India and distribution required more manpower to be deployed in rural areas. All rural financial institutions need special dispensation suited to their local potential and challenges.

The overall position of RRBs in India is not quite encouraging. The poor credit-deposit ratio is still making dent on the improvable functioning of RRBs. Since the RRB is supposed to be a bank for poor people, its presence in all the states of country especially in underdeveloped States can make things better. The government should spread the branches of RRBs at grass root level to provide such banking service to the really needy rural people.

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Moreover, it is the responsibility of the bank management and the sponsored bank to take corrective measures to raise the credit deposit ratio of the bank that would make RRBs relevant in the rural India.

Significant Improvement In Regional Rural Banks Performance: The establishment of the Regional Rural Banks was initiated in 1975 under the provisions of the ordinance promulgated on 1975 and thereafter Section 3(1) of the RRB Act, 1976. The issued capital 148 of RRBs is shared by Central Government, sponsor bank and the State Government in the proportion of 50 per cent, 35 per cent and 15 per cent respectively. The area of operation of a majority of the RRBs is limited to a notified area comprising a few districts in a State. In the year 2005, a process was initiated for the structural consolidation of RRBs sponsored by the same bank within a State. As a result of amalgamation, 196 RRBs were reduced to 133 by way of amalgamation as on 2006 and have been further reduced to 102, as on date. The amalgamated RRBs will reap benefits of staff rationalization, increased quantum of advances and investments on the increased capital base and the benefit of larger resources and economies of scale.

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