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PERFORMANCE REVIEW OF REGIONAL RURAL BANKS IN INDIA USING RATIO ANALYSIS

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Abstract

Banking industry has been amongst the few to maintain resilience despite bankruptcy of banking and financial institutions, despite the debt crisis in major economies of the world. The tempo of development for the Indian banking industry has been remarkable over the past decade before liberalization era; the picture of Indian banking was completely different. The study was mainly conducted in order to see the impact of banking sector reforms on the performance of Regional Rural Banks with respect to productivity and efficiency of the banks can be evaluated with various ratios; non-interest margin to total assets, operating cost to total assets and non-interest income to total income returns on assets, net profit and operating profit. The major implications of the study were that the performance of these banks worsened in the initial years of reforms, however, the performance improved thereafter gradually after 1996-97. In the nut shell, the ratio analysis demonstrates that the banking sector reforms have provided the platform to the Regional Rural Banks to attain the targets of rural development and financial inclusion. The success of a bank depends upon the management of these ratios so that they have to be kept within the tolerance level.

Keywords: Liberalization era, Regional Rural Banks, Ratios Analysis.

INTRODUCTION

India's banking industry has been amongst the few to maintain resilience despite bankruptcy of banking and financial institutions, despite the debt crisis in major economies of the world. The tempo of development for the Indian banking industry has been remarkable over the past decade. The general banking scenario in India has become very dynamic now-a-days. Though the entry and growth of new private banks over the last two decades has transformed the Indian banking industry, the government-controlled banks still dominate. Before liberalization era, the picture of Indian banking was completely different. The government of India (GOI) initiated measures to play an active role in the economic life of the nation resulting into greater involvement of the state in different segments of the economy including banking and finance. The new rules of competition require recognition of the importance of consumers and the necessity to address the needs through innovative products supported by new technology. The biggest opportunity for the Indian banking system today is the Indian consumer. Though the growth in consumer credit has been most evident in urban areas, in recent years semi-urban and even rural areas are witnessing excellent growth in this segment.

After the nationalization of major commercial banks, the Indian commercial banking undoubtedly made rapid progress in terms of geographical coverage, deposits mobilization and credit deployment. But in this process, efficiency, productivity and profitability suffered. The government at this moment decided to introduce inclusive economic reforms with the basic aim of establishing a sound and viable banking system, which would help the development of the real economy. Therefore, on August 14, 1991, a nine-member High Level Committee on the financial system was set up to examine all aspects relating to the structure, organization, functions, and procedures of the financial system. The committee headed by Narasimham, submitted a summary report to the government of India on November 8, 1991, and the main report on November 16, 1991 (RBI, 1991).

Rural finance is a matter of great concern in an agrarian economy like India (Antony, 2005). The privately-owned commercial banks were neither interested nor geared to meet the risky and small credit requirements of the farmers. Similarly, the share of other non-industrial sectors in bank credit was also low. The Narasimham Committee, in July, 1975 observed that the cost structure of commercial banks, the approach of bank employees and the lack of a professional approach in the co-operative credit system were the main faltering blocks to rural credit. The committee also perceived that the deposits collected by banks from rural areas were not completely deployed there. The panel, therefore, recommended the creation of a new set of regionally oriented rural banks which would combine a co-operatives local feel and a commercial bank's business acumen. The government accepted these recommendations and, accordingly, the ordinance of RRBs, 1975 was promulgated on September 26, 1975. This was swapped by the RRBs Act, 1976 on February 9, 1976. RRBs started their development process on 2nd October 1975. Originally there were only 6 RRBs in 1975 and increased to 196 in 2005. The number of banks remained same 196 till 2005 and which reduced to 64 in 2013 due to structural consolidation of RRBs by amalgamated RRBs.

The present paper is separated into five sections. First section of the present paper explains the function of bank concerning the priority/weaker sectors. It also discusses the regional rural banks in India and plan of the article. In second section, an attempt has been made to review the empirical studies related the working of RRBs in India highlighting the problems and prospects of RRBs. Third section discusses data base and methodology. Fourth section explores the Performance appraisal of Regional Rural Banks in India which can be evaluated with various ratios; non-interest margin to total assets, operating cost to total assets and non-interest income to total income returns on assets, net profit and operating profit of

Regional Rural Banks. Fifth and the last section end up with conclusion pertaining to the regional rural banks in India in India.

LITERATURE REVIEW

Dutta (1976) discussed that the present structure of banking had been successful in attending the desirable kind of branch expansion and in advancing adequate credit to agriculture and other high-priority sector. Moreover, wasteful competition should be eliminated with the introduction of a system which offered banking service in depth in the areas allocated to the different units. There was a need for regionally grouped compact zones, each served by a single public sector zonal bank with full stake in the development of the zone and with a quick communication link with its constituent branch offices. Mukherjee (1976) recommended the establishment of RRBs with the intention to have rural touch and local feel, a familiarity with rural problems. Kant (1977) undertook the Haryana Kshetriya Gramin Bank, Bhiwani (Haryana) and the Jaipur Nagaur Aanchalik Gramin Bank, Jaipur (Rajasthan) till period and found that working of the RRBs was influenced by specific local conditions which vary from place to place. the study suggested the need to bring out some of the key issues so that their performance could be improved to make it imperative to conduct case studies of their performance and problems. Kamath (1978) observed that in India there was multi-agency approach to finance agriculture. These were co-operative banks, commercial banks and the RRBs sponsored by commercial banks. The role of RRBs was to supplement the institutional agencies and not to replace the other institutional agencies in the field of agriculture finance. Kumar (1993) studied the progress and performance of the RRBs in India from 1979-80 to 1989-90. The findings of the study suggested that the RRBs should mobilize deposits in order to increase the amount of advances. Deogirikar (2001) examined the non-performing assets (NPA) of Aurangabad-Jalna Garmin banks in Maharashtra for the year 1998. The findings of the study revealed that NPA was a serious problem faced by the banks. The study suggested the need of proper monitoring and follow- up in collaboration with government and voluntary agencies. Malhotra (2002) discussed the issue of location with reference to 22 different parameters that had an impact on the functioning of RRBs in India for the year 2000. Prasad (2003) examined the performance of all RRBs in the context of pre and post -financial sector reforms period during the period 1975 to 2002. It suggested the various measures that were initiated for revamping the RRBs had resulted in overall growth in the financial health of RRBs to sustain their growth. Yadappanvar and Nath (2003) conducted a case study of Aurangabad - Jaina Gramin Bank which had been operating since 1983. This study showed that the bank had achieved significant progress on several fronts such as at branch level, per employee business, loans advances and deposits wise.. This study concluded that right motivational climate, teamwork and supportive work culture have helped to bring out the best in the employees. There was a deliberate strategy to bring down the ratio of investment credit to working capital loans. This resulted in great profitability from its loan portfolio. Ahmad (2006) made an attempt to analyze the business performance of all RRBs covering deposits, outstanding advances and loans, investment, credit- deposit ratio and recovery of loans. This study suggested the need of liquidation for the non-viable RRBs. Satyasai (2008) examined a few structural constraints that hamper the credit delivery system and also discussed some of the measures taken to improve the situation. Sharma and Sharma (2010) analyzed the comparative performance of the Himachal Gramin Bank (HGB) and Parvatiya Gramin Bank (PGB)on the basis of investment, loan and advances, resource mobilization and non-performing assets for the year 2000 to 2009 The study found that the investment position of the HGB was much better than the PGB; both the banks had made a commendable progress in the credit expansion during the period under study. Rangaswamy and Gopalappa (2011) tried to focus on the performance of the credit delivery by various institutions like CCBs, RRBs and CBs to the agriculture sector over a period of time i.e., from 1990-91 to 2008-09. The study suggested that the organized credit should increase further so that cent per coverage was achieved and farmers' exploitation by the private money lenders was reduced. Soni and Kapre (2012) analyzed the performance of Durg Rajnandgaon Gramin Bank in Chhattisgarh during the period from 2009 and 2011. He undertook income, expenditure, assets, liabilities, recovery position and staff strength to full fill the objectives. The study found a few problems faced by bank as not mobilizing deposits because of severe competition from other banks and financial institutions, lack of coordination in branch expansion, delay in the sanction of loans and recovery procedure of bank were very poor.

METHDOLOGY

The impact of banking sector reforms on the performance of RRBs with respect to productivity and efficiency of the regional rural banks can be evaluated with various ratios. Table 1 Table 2 is indicators of the productivity and efficiency of banks and reflects on certain aspects of a banks functionary. The present study is based upon secondary data. The study has considered the period from 1991-1992 as the reforms period was started from this period. The period is selected up to 2011-2012 as the data is available from this period. . In addition, the post liberation period has been , bifurcated into distinct two sub-periods viz: first generation reforms period (1991-1992 to 1997-98) and second generation reforms period (1998-1999 to 2006-2007) to show how the magnitude of efficiency and productivity scores vary with the change in the degree of first-generation reforms period to second- generation reforms period. The data have been culled out from various issues of Statistical Tables Relating to Banks in India; Report on Trend and Progress in Banking; Manual on Financial and Banking Statistics; RBI monthly Bulletins published by RBI and various issues of Financial Analysis of Regional Rural Banks;

Regional Rural Banks Key Statistics and Review of Performance of Regional Rural Banks published by National Bank for Agriculture and Rural Development (NABARD). Apart from above mentioned sources, data has also been compiled from compact disc on "Statistical Tables Relating to Banks in India (including RRBs) 1979 to 2007" available from Reserve Bank of India, Mumbai.

ANALYSIS & PERFORMANCE APPRAISAL OF RRBS

The impact of banking sector reforms on the performance of RRBs with respect to productivity and efficiency of the regional rural banks can be evaluated with various ratios. Table 1 and Table 2 are indicators of the productivity and efficiency of banks and reflect on certain aspects of a banks functionary.

Table 1 highlights that net-interest margin to total asset ratio of RRBs increased from 2.55 per cent in 1991-92 to 2.89 per cent in 1997-98 during first generation reforms period. During second generation reforms period 1998-99 to 2010-12, ups and down in ratio was noticed but still, it was higher than first generation reforms period. During this reforms period, net-interest margin to total asset ratio recorded highest i.e., 3.33 percent in 2000-01 and minimum 2.99 percent in 2008-09. It is the difference between the total interest earned and the total interest expanded, normalized by assets. This ratio indicates as to how effectively the banks deploy all their funds to generate income from credit and investment operations. The lower the ratio, the more efficient is the banking system. If this ratio is less, it depicted that bank has great ability in making income through the utilization of funds. As far as operating cost to total asset ratio is concerned, it was recorded highest in the beginning of the reforms period i.e., 5.07 percent in 1991-92 and lowest 2.11 percent in 2008-09. Operating costs to total assets indicates the amount of operating costs expended per unit of assets. The larger the ratio, lower is the efficiency. In nutshell, that cost asset ratio of RRBs, which declined sharply between 1991-92 to 2000-01, increased gradually in 2001-02, 2002-03 and 2006-07. And remaining years had shown the decline trend. Looking at the table, second- generation reforms period from 1997-98 to 2010-12 has comparative less value than first generation reforms period. This analysis resulted that second generation reforms period outperformed the first generation reforms period. Although, non-interest income to total income cannot be classified as accounting measure that has been used to indicate the diversification of operation of banks. Table depicts that upwards and downwards variations are noted throughout the year. The lower the ratio, the smaller will be the efficiency in the banking system. Lower Ratio is found during first-generation reforms period as compared to second-generation reforms period. Therefore, higher efficiency is observed during first generation reforms period. Table 1can be represented with given trend line diagram 1.

Table 1: Non-Interest Margin to Total Assets, Operating Cost to Total Assets and Non-Interest Income to Total Income of RRBs in India -1991-92 to 2011-12

Year	Net-Interest Margin to Total Assets	Operating Cost to Total Assets	Non-Interest Income to Total Income
1991 -92	2.55	5.07	3.69
1994 - 95	2.06	4.41	5.85
1995 - 96	1.88	3.83	5.89
1996 - 97	2.34	3.30	4.82
1997 - 98	2.89	2.87	4.93
1999 - 00	3.25	2.50	4.99
2000 - 01	3.33	2.35	4.94
2002 - 03	3.12	2.67	7.39
2003 - 04	3.10	2.60	11.19
2004 - 05	3.23	2.52	7.68
2006 – 07	3.15	2.51	7.09
2008-09	2.99	2.11	6.75
2009-10	3.03	2.16	6.76
2010-11	3.09	2.21	6.70
2011-12	3.13	2.24	6.74

Source: Computed from various issues of Statistical Table Relating to Banks in India

(In per cent)

Diagram 1: Non-Interest Margin to Total Assets, Operating Cost to Total Assets and Non-Interest Income to Total Income of RRBs in India -1991-92 to 2011-12

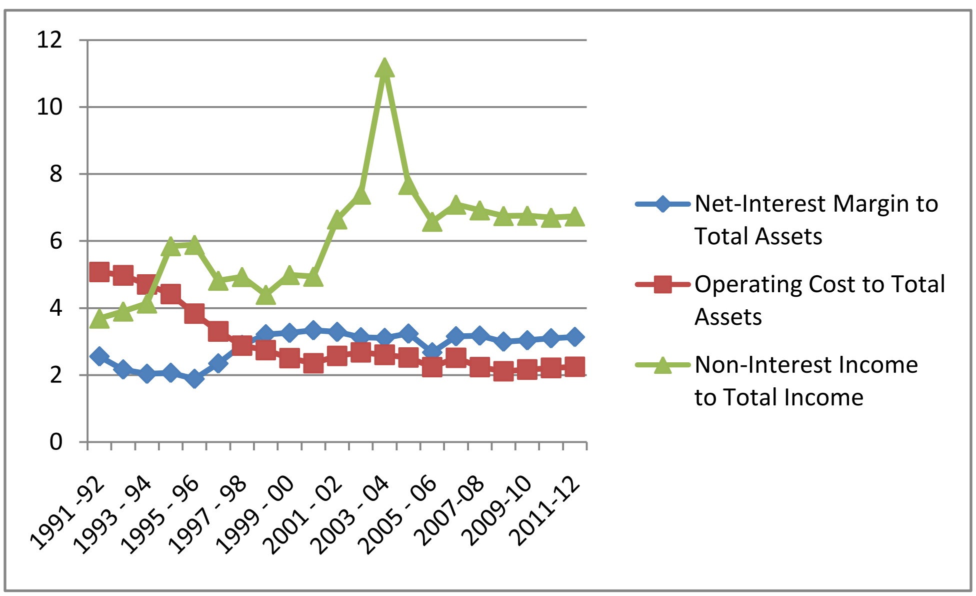


Table 2 depicts the returns on assets, net profit and operating profit of RRBs in India from 1991-92 to 2011-12. Returns on assets give an indication as to how much profit of banks is able to generate per limit of its assets. Higher value of their ratio is indicated of higher profitability, and hence, productivity. As per Base 2 norms the returns on assets should be more than one per cent (Ghosh, et.al, 2004). It was (-1.46 percent) in 1991-92, followed by same five years negative returns and later on consistent rise in returns on assets up to 2000-01and then after, fluctuations were noticed in returns on assets. Lower returns on assets highlighted that a firm has heavily invested in assets formation, in general and new technology, unparticular. On account of reforms RRBs registered substantial increase in returns on assets from (-1.46 percent) in 1991(-2 to 0.39 percent) in 1998-99 and further to (1.01 percent) in 2011-12. It shows that second generation reforms period has positive impact on returns rather than first generation reforms period. This sharp increase in returns on assets ratio may be attributed due to the contribution of income from off-balance sheet activities to the profits.

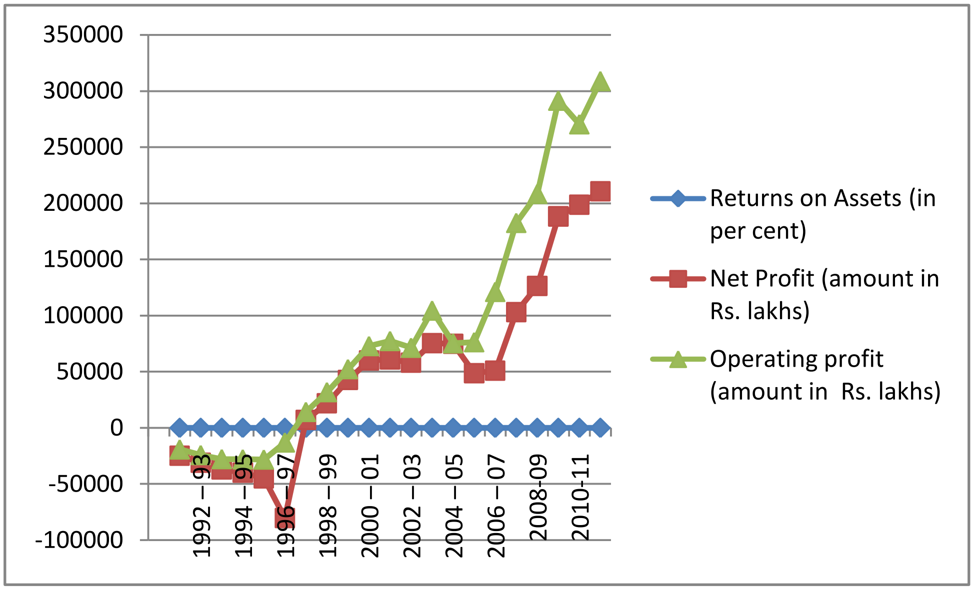
As well as in terms of net profit, the performance of RRBs testified a deleterious enhancement from Rs.24700 in 1991-92 to Rs.80300 in 1996-97 and after this, RRBs revealed progress from Rs.7100 lakhs in 1997-98 to Rs.210741 lakhs in 2011-12. This change described the favorable impact of reforms is noticeably grasped during the second- generation reforms period. The performance of RRBs with respect to operating profit reported that during the beginning of the first- generation reforms period 1991-92, operating profit was found negative Rs.19100 lakhs in 1991-92 to Rs.12900 lakhs in 1996-97 and only in one period i.e., it was positive i.e. Rs.14300. But during second generation reforms period i.e., 1999 onwards, there was marked improvement in operating profit i.e., from Rs. 31900 in 1998-99 to Rs. 308745 in 2011-12 and thus the constructive impact of reform is clearly observed on the performance level of RRBs in second generation reforms period. Table 2 can also be represented with given trend line diagram 2.

Table 2: Returns on Assets, Net Profit & Operating profit of RRBs in India -1991-92 to 2011-12

Year	**Returns on Assets (in per cent)**	**Net Profit (amount in Rs. lakhs)**	**Operating profit (amount in Rs. lakhs)**
1991 -92	-1.46	-24700	-19100
1993 – 94	-1.62	-36900	-27700
1994 – 95	-1.51	-39800	-27900
1997 – 98	0.15	7100	14300
1998 – 99	0.39	22000	31900
1999 – 2000	0.68	42800	52400
2000 – 01	0.79	60100	72900
2003 – 04	0.73	75500	104500
2004 – 05	0.65	75000	75400
2005 – 06	0.58	48800	76367
2006 – 07	0.52	50900	121126
2008-09	0.92	126400	208287
2009-10	0.95	188423	291324
2010-11	0.99	198812	270314
2011-12	1.01	210741	308745

Source: Computed from various issues of Statistical Table Relating to Banks in India

Diagram 2: Returns on Assets, Net Profit & Operating profit of RRBs in India 1991-92 to 2011-12



CONCLUSION

The impact of banking sector reforms on the performance of RRBs with respect to productivity and efficiency of the regional rural banks can be evaluated with various ratios. Banking industry has been amongst the few to maintain resilience despite bankruptcy of banking and financial institutions, despite the debt crisis in major economies of the world. The tempo of development for the Indian banking industry has been remarkable over the past decade before liberalization era; the picture of Indian banking was completely different. After the nationalization of major commercial banks, the Indian commercial banking undoubtedly made rapid progress in terms of geographical coverage especially in rural areas, deposits mobilization and credit deployment. New set of regionally oriented rural banks which would combine a co-operatives local feel started regional rural banks. The impact of banking sector reforms on the performance of RRBs with respect to productivity and efficiency of the regional rural banks can be evaluated with various ratios; Non-Interest Margin to Total Assets, Operating Cost to Total Assets and Non-Interest Income to Total Income Returns on Assets, Net Profit and Operating profit of RRBs. Non-Interest Margin to Total Assets ratio indicates as to how effectively the banks deploy all their funds to generate income from credit and investment operations. The lower the ratio, the more efficient is the banking system. If this ratio is less, it depicted that bank has great ability in making income through the utilization of funds. As far as operating cost to total asset ratio is concerned, it was recorded highest in the beginning of the reforms period i.e., 5.07 percent in 1991-92 and lowest 2.11 percent in 2008-09. This analysis resulted that second generation reforms period outperformed the first generation reforms period. Although, non-interest income to total income cannot be classified as accounting measure that has been used to indicate the diversification of operation of banks. Table depicts that upwards and downwards variations are noted throughout the year. The lower the ratio, the smaller will be the efficiency in the banking system. Lower Ratio is found during first-generation reforms period as compared to second-generation re forms period. Therefore, higher efficiency is observed during first generation reforms period

Returns on assets give an indication as to how much profit of banks is able to generate per limit of its assets. Higher value of their ratio is indicated of higher profitability, and hence, productivity. It shows that second generation reforms period has positive impact on returns rather than first generation reforms period. This sharp increase in returns on assets ratio may be attributed due to the contribution of income from off-balance sheet activities to the profits. As well as in terms of net profit, the performance of RRBs testified a deleterious enhancement from Rs.24700 in 1991-92 to Rs.80300 in 1996-97 and after this, RRBs revealed progress from Rs.7100 lakhs in 1997-98 to Rs.210741 lakhs in 2011-12. This change described the favorable impact of reforms is noticeably grasped during the second- generation reforms period. The performance of RRBs with respect to operating profit reported that during the beginning of the first- generation reforms period 1991-92, operating profit was found negative and the constructive impact of reform is clearly observed on the performance level of RRBs in second generation reforms period. The major limitations of the study with respect to ratio analysis has been observed that managerial in capabilities are responsible for this in India. So it is required that adequate efforts should be there to achieve desired levels of excellence in staff competence for managing the affairs and business of banks. Because the success of a bank depends upon the management of these ratios so that they have to be kept within the tolerance level. Thus it is proved that the RRBs have made significant improvement in asset quality, despite tightening of norms since mid-1990's. Overall scenario depicted that the performance of RRBs worsened in the initial years of reforms, however, the performance improved thereafter gradually after 1996-97. In the nut shell, the ratio analysis demonstrates that the banking sector reforms have provided the platform to the RRBs to attain the targets of rural development and financial inclusion.

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