

Viability of RRBs as Rural Financial Institutions of India: A Micro-Level Study in the Context of Liberalised Environment

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The process of liberalization, privatization and globalization, has started relatively late in India, but its direct impact has been experienced in all sectors of its economy. When it comes to financial sector "the ongoing reform process has aimed at making the financial sector more viable and more efficient. The major policy thrust has been to improve the operational and allocative efficiency of the system, by reducing many of the exogenous and structural factors affecting the performance of banks and financial institutions" (Rangarajan 1993:987). Banking institutions, being the major constituents of the financial system have absorbed the maximum impact of various new policy measures. At the face of the new policy measures, the viability of these institutions assumes immense significance because of their predominance over the total asset size of the entire financial sector.

As a constituent of the Indian public sector commercial banking network¹, RRBs have been operating as rural financing institutions² for more than 26 years. The establishment of Regional Rural Banks in 1975 was one among the various policy initiatives taken by the Indian government to broaden the outreach of formal credit systems to the rural population. The rationale as laid down in the preamble of RRB Act, 1976 is to "develop the rural economy by providing, for the purpose of development of agriculture, trade, commerce, industry and other productive activities in the rural areas, credit and other facilities, particularly to the small and marginal farmers, agricultural laborers, artisans and small entrepreneurs, and for matters connected therewith and incidental thereto". The role-played by the

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1. As on 31st March 2002 the network of commercial banks consists of 27 public sector banks, 33 private sector banks, 40 foreign banks and 196 Regional Rural Banks (RRBs).
 2. The rural credit institutional (banking) network consists of a) Short-term cooperative credit structure (SCB, DCCB and PACS), b) Long-term cooperative credit structure (LDB/ARDB), c) Commercial Banks (CBs) and d) Regional Rural Banks (RRBs). Out of more than 66000 commercial bank branches, the RRBs have 14311 branches from which 90 percent are in rural areas.

RRBs so far remains long away from that was initially expected. Instead of being the agents to cure ailment of our rural economy RRBs over the years have emerged as sick financial institutions seeking intensive care and for this reason perhaps, they have invited utter criticism from many noted economists and financial experts. "But, it is surprised and rather sad that despite the best analysis of the problem and the said advice tendered over the years the problems instead of being resolved appears to be compounded" (Tarrapore 1994:1073). The problem of rural credit has been associated with poor recovery and high cost of servicing. The RRBs because of the predominance of rural sector in their operational domain are severely affected by the default syndrome. The large volume of non-performing assets (NPA) coupled with high operational expenses has generated heavy accumulated losses for RRBs.

In recent years, particularly during the era of liberalization criticism has been raised over the viability of RRBs and their effectiveness in managing rural credit is still under scrutiny. In the present context, where accountability of public financial institutions is gaining more importance in the society, these RRBs have not shown the desired results. Even the recent expert committee report on rural credit emphasizes that only financially viable credit institutions can provide sustainable support to the rural masses (NABARD 2001). It is aptly said by Rangarajan (1993), "banks must become efficiency conscious and focus on balancing profitability with liquidity, while also servicing the necessary socio-economic objectives of our development efforts". There is thus an urgent need to evaluate the performance of these RRBs in order to identify the areas of their deficiency and to provide some strategic remedial measures to improve their performance.

On the above backdrop, an attempt has been made in this paper to highlight the performance of RRBs by means of some selected indicators, identify the determinants of profitability and major problem areas with a view to offering a line of suggestion to enhance their economic viability and competitive strength. Limiting the scope of the paper to the geographical area 'North East India' and a period of ten years i.e 1991-92 to 2000-01, the analysis has been made both at macro and micro level. The next section of this paper outlines the retrospect of RRBs by tracing back its genesis and their prospects in the reform era. The financial position of all RRBs *vis-à-vis* their position in Northeast region has been presented in the following two sections describes the micro level study on one RRB and its branches. The last section provides the strategic interventions to the gray areas identified on the basis of the findings.

RRBs – Retrospect and Prospects

In nineteen sixties the excessive commercial motive and reluctance of commercial banks to extend credit facility to rural mass for fostering the development of priority sector was widely felt and as a result a committee (All India Rural Credit Review Committee) was established to look into the matter. The Review Committee observed that, even after the commercial banks had overcome their earlier reluctance to carrying banking facilities to smaller centers and had derived deposits from these centers which grew steadily, they had not, till recently, made any significant progress in fulfilling the complementary responsibility of meeting the credit needs of the semi-urban and rural areas (RBI 1969). It is only after the first nationalization of banks in 1969, the focus of commercial banks was shifted to the rural areas with the mechanism of priority sector lending targets. Subsequent to this, the Banking Commission recommended the structure of banks in rural areas so as to provide a wide range of banking services with economic viability (GoI 1972). Despite the development on this front, there

was a growing realization in early seventies that the ethos and attitudes of commercial banks were not conducive to meeting the credit needs of agriculturists and other weaker sections in the rural areas in view of the relatively high cost structure and inadequate local environment (Ammanaya 1989:8). During this period a committee was appointed to study in depth the problem of devising alternative agencies to provide institutional credit to the rural people, identify weakness of the cooperative credit agencies and commercial banks, and recommend a new type of institution "which combines the local feel and familiarity with problems which cooperatives possess and the degree of business organization, ability to mobilize deposits, access to central money market and a modernized outlook which the commercial banks have" (Desai 1987:39). Thus keeping in view of the earlier recommendation of the Banking Commission, 1972 for an alternate rural credit institution, it is the final recommendation of the working group (GoI 1975) of Sh. Narashimham which gave birth to Regional Rural Banks (RRBs) in 1975.

Over the years, it is found that in the process of providing equitable justice to all the sectors banks have landed themselves in a piquant situation. Poor credit off-take, dismal recovery and deterioration in quality of assets, high operational cost and less than expected profitability are some of the common features of Indian banking. RRBs are not the exception to the above syndrome. Greater emphasis on directed credit; regulated interest rate structure; lack of focus on profitability; lack of transparency in the bank's balance sheet; lack of competition; excessive regulation on organization structure and managerial resource; excessive support from Government; poor customer service, outdated technology and high transaction cost; and political interference are some of the factors that led to their lackluster performance. To deal with these deficiencies several reform measures were thus initiated in this sector.

Banking reform in India can be traced back to the nationalization of 14 Indian commercial banks in 1969 and six in 1980, which was mainly undertaken to bring a balanced regional economic development through the provision of adequate finance. Since these days the Indian banks have achieved a remarkable growth in business but the quantitative expansion of business has not matched with qualitative banking services. To address the causal factors of the dismal performance and to cope up with the liberalization pressure from the real sector a high level committee under the chairmanship of M. Narashimham was set up in 1991 (GoI 1991). The first report of this committee provided the blue print of the first-generation banking sector reform and the second report (GoI 1998) asked for the second-generation reform by consolidating the gains already achieved. These reforms aim to enhance the viability and efficiency of the banking sector. To tackle the internal deficiencies of the sector, new norms relating to accounting practices, prudential standards and capital adequacy requirements have been suggested. On the other hand, for improving the external environment, the reform aimed at transforming the highly regulated environment into a market-oriented one. Since RRBs are a part of overall banking system most of the reform measures have also affected their operation. The deregulation of interest rate has given more operational flexibility. Reduction of pre-emptive reserves like Statutory Liquidity Ratio and Cash Reserve Ratio has released more money at their hands for business. The provision of expansion of operations to non-traditional areas like consumer loans, housing loans etc. has boosted their income generation ability. Permission to invest in stock market has given opportunity to improve their bottom-line. The permission to relocate and closer of bank branches has helped them to augment their business. The concerted approach to handle the NPA has helped the RRBs to improve their recovery and boost their profitability. But the enhancement of pay structure has increased their operational expenses, which in turn affected their profitability adversely.

It is found that "over the years the performance of public sector banks has become more responsive to changes in the market-place, with growing emphasis on profitability as an indicator of performance as opposed non-commercial considerations in the pre-reform era" (Das 2002: 439). But the RRBs are

still languishing under the stereotype mindset. It is growingly felt that the regulators have not given proper attention to the functioning of RRBs. In some quarters it is opined that RRBs as rural financial institutions have been sidelined in the reform process (Malhotra 2002). Concerns are being expressed about their operational efficiency and their ability to successfully face the competitive pressures. In the context of liberalization, what should be spirit of the banking institutions is very much visible in the statement, "the improved functioning of the banking sector therefore is a necessary pre-requisite for the overall improvement of the economy. Banks must find new ways and methods to respond adequately to the positive changes being ushered in by the financial sectors. The spirit of enterprise in the banking industry must rise to the occasion. Fears of adjustment must be replaced by a commitment to seek out new opportunities and excel" (Rangarajan 1993: 989).

RRBs – The Present All-India Scenario *vis-à-vis* of North Eastern Region

Over the last 26 years, a total number of 196 RRBs with more than 14000 branches have reached nook and corner of all the Indian states except Goa and Sikkim. Out of all the RRBs, 172 RRBs have earned profit during the year 2000-01 as against 162 banks in 1999-00 (NABARD 2000-01: iv). RRBs with no accumulated losses are found high in the case of Punjab (4 out of 6), Andhra Pradesh (12 out of 16) and Karnatak (8 out of 13). Simultaneously, the loss-incurring RRBs *vis-à-vis* the total number of RRBs is particularly high in the case of Orissa (4 out of 6), Madhya Pradesh (6 out of 24) and Bihar (5 out of 22) (NABARD 2000-01: iv). In order to reveal the impact of much needed branch expansion programme of the RRBs one can have a look on the key indicators of their performance as they stand on 31st March 2001 (Table 1). The national level C/D ratio at 41 percent ranging between 121 percent (for Kerala) and 17 percent (for Jammu and Kashmir), NPA of 18 percent ranging between 64 percent (for Tripura) and 5 percent (for Kerala), recovery rate of 69 percent in the range of 90 percent (for Kerala) and 18 percent (for Tripura), employee productivity at Rs. 7.7 ml. in the range of Rs 11 ml. (for Punjab) and Rs. 2.4 ml. (for Nagaland) and branch productivity of Rs. 37.8 ml. ranging between Rs. 60.2 ml. (for Tripura) and Rs. 8.5 ml. (for Nagaland), as envisaged in the table clearly portray a gloomy picture of their operation. The high co-efficient of variation computed for the above suggest the wide dispersion of Indian state around the national level performance. Further, very high positive coefficients of skewness computed for C/D ratio and NPA and moderate negative coefficients for recovery rate, employee productivity and branch productivity suggest skewed performance of RRBs across the states. The negative coefficients for recovery rate, employee productivity and branch productivity necessitate further analysis at regional basis.

Out of the total 196 RRBs as on 31st March 2001, 11 RRBs (5.6 percent) are operating in North East region with 651 branches (4.5 percent) and 3252 staff. Out of all 11 RRBs 5 are located in the state of Assam where as the rest is equally spread in six other states. Comparison of the percentage of number of RRBs and their branches (5.6 percent and 4.55 percent respectively) with the net accumulated loss (9.59 percent) in this region clearly reveals a relatively unsatisfactory profitability performance of the RRBs. When it comes to operating performance the region registers all the indicators far short of national achievement. As on 31st march 2001, the computed C/D ratio of 30 percent against 41 percent at national level, recovery rate of around 36 percent against the national average 69 percent, NPA percentage of 46.6 against 18 percent, per employee productivity of Rs. 6.2 ml. against Rs. 7.7 ml., and branch productivity of Rs. 30 ml. against Rs. 37.8 ml. at the national level provide ample evidence to prove the above statement. While the recovery rate at all-India level has been improved to

69 percent from the earlier 47.5 percent during the period 1983-91 (Mosley 1996), it still hovers around 36 percent for this region as a whole. The macro-level performance indicators at the national-level portray a rosy picture of rural banking in India but behind the quantitative progress there remains hidden deterioration in quality banking, causing stagnation in rural banking in the North and North East region and the resulting effect of persistent regional disparity (Shivamaggi 2000).

Among all the states of NE region, two states namely Assam and Tripura holding Rs. 1102.9 ml. and Rs. 1394. ml. respectively account for nearly 93 percent of the total accumulated losses in this region and 9 percent of the country. Except Arunachal Pradesh the C/D ratio of all other states in the region stand much below the C/D ratio of national level. This picture gets further deteriorated when Assam, the state having 5 RRBs with 401 branches (61 percent) registers a C/D ratio of only 27 percent against 30 percent for the NE region as a whole. Recovery rates recorded for all the states in this region range between 18 percent for Tripura to 54 percent for Mizoram against the national average of 69 percent. Assam the major state of the region enjoys a recovery rate of 38 percent, which is almost half of the all-India recovery rate. The percentage of NPA, a measure to reveal the financial ailment of a bank recorded for all the states in this region exceeds the national average. Assam recording a NPA of 33 percent and Tripura with 64 percent (the highest in the country) deserve special mention to highlight the precarious asset management at the state level.

The above analysis of aggregate performance indicators reflect at macro-level a gloomy picture of rural banking scenario in North East India and warrants remedial strategic and managerial interventions to bring the RRBs back on the track for accomplishing the avowed objectives enshrined in the preamble of RRB Act. This is possible only when the contributing factors are known and analyzed at the operational level of the banking organization and this arises the need to have a micro-level analysis of covering a fairly long period of time.

A Micro-Level Study

To have a micro level analysis of the profitability, Subansiri Gaonlia Bank (SGB)³ has been chosen. The justification for its choice is three fold: (i) its operational jurisdiction in four districts of the major state Assam (out of which two are backward) to justify the rural character of the bank (ii) the median performance with respect to all the performance indicators and (iii) the recent turnaround of its profitability. The analysis based on secondary data has been made both at corporate and branch level (confining the scope to only one operational district i.e. North Lakhimpur where altogether 16 branches are operating) to reveal the profitability predictors. The analysis covers a time period of ten years i.e. 1991-92 to 2000-01 and the major sources of data include the annual report of the bank and records of various branches.

3. SGB is one of the five RRBs in the state of Assam (Assam is the well-off state in the Northeastern part of India, which is considered as the most backward region). It was established on 30th March 1982 under the Section 3(i) of the RRB Act, 1976. This bank covers four districts of Assam, namely North Lakhimpur, Dhemaji, Dibrugarh and Tinsukia. The Headquarters of the bank is located at North-Lakhimpur. The bank covers 4620 Revenue villages falling in 23 Development Blocks of the 8 Sub-divisions. Out of the total 45 branches spread across the four districts, North Lakhimpur has 16 branches followed by Dibrugarh 12 branches, Dhemaji 9 branches and Tinsukia 8 branches (Pati 2002).

Table 1
Selected Indicators of RRBs in India as on 31st March 2000-01

Sl. No.	States	No. of RRBs	No. of Branches	C/D Ratio %	Recovery as on 31/03/00 (%)	NPA (%)	Accumulated Losses Rs ml.	Profit /Loss Rs ml.	Per Employee Productivity	Per Branch Productivity
1	Arunachal Pradesh	1	19	107	38	19	6.8	3.3	9.9	33.8
2	Assam	5	401	27	38	33	1102.9	34.7	5.8	38.6
3	Manipur	1	29	38	35	46	109.3	-3.2	3.0	10.9
4	Meghalaya	1	51	25	43	45	0	31.9	8.4	30.0
5	Mizoram	1	58	34	54	35	60.0	4.2	5.1	16.9
6	Nagaland	1	85	28	28	42	14.4	9	2.4	8.5
7	Tripura	1	85	30	18	64	1394.0	-81.9	7.2	60.2
8	NE Region (1 to 7)	11	* 651	30	36	46.6	2687.4	-10.1	6.2	30.8
9	Andhra Pradesh	16	1101	66	73	11	549.2	709.6	8.9	46.5
10	Bihar	22	1869	23	50	32	5786.2	388.8	7.2	30.7
11	Gujarat	9	388	49	77	15	311.0	211.4	9.2	38.8
12	Haryana	4	192	50	79	11	286.6	310.4	9.7	53.0
13	Himachal Pradesh	2	130	25	76	6	0	66.4	10.7	48.5
14	Jammu & Kashmir	3	262	17	42	21	793.7	17.2	6.1	28.2
15	Karnatak	13	1093	81	77	11	248..5	7479	7.6	40.4

To be cont'd

Table 1
Selected Indicators of RRBs in India as on 31st March 2000-01 (Cont'd)

Sl. No.	States	No. of RRBs	No. of Branches	C/D Ratio %	Recovery as on 31/03/00 (%)	NPA (%)	Accumulated Losses Rs ml.	Profit /Loss Rs ml.	Per Employee Productivity	Per Branch Productivity
16	Kerala	2	325	121	90	5	0	326.0	6.8	54.5
17	Madhya Pradesh	24	1496	32	62	21	4288.9	204.8	72	30.4
18	Maharastra	10	581	49	66	21	1142.1	131.0	6.8	29.1
19	Orissa	9	823	51	66	19	3954.2	-110.8	6.5	33.6
20	Punjab	5	202	38	85	9	40.5	232.7	11.0	41.4
21	Rajasthan	14	1025	41	72	13	2367.1	153.3	7.5	32.3
22	TamilNadu	3	212	84	84	6	177.6	91.8	7.7	39.3
22	Uttarpradesh	40	2995	31	60	27	2431.3	2464.0	8.5	42.9
24	West Bengal	9	871	32	47	28	2966.1	156.5	7.2	43.3
25	All India	196	14311	41	69	18	28030.3	6090.6	7.7	37.8
26	Coeff. Var.	113.32	117.33	58.49	34.14	61.19	132.01	285.88	28.61	35.55
27	Skewness	1.90	1.89	1.50	-0.3	0.96	1.45	4.13	-0.57	-0.4

Source: Compiled from Key Statistics for RRBs, NABARD, 2000-01

Analysis at Corporate Level

SGB, the rural bank identified to reflect upon the micro level performance in NE region reveals very interesting phenomenon that has paramount significance in reshaping the rural banking in India. The bank, with a consistent increase in its deposit outstanding from Rs 112.84 ml in 1991-92 to Rs 780.41 ml. in 2000-01 has registered a high growth rate of 25 percent over the period of 10 years. During the same period the advance extended has also increased from Rs.71.47 ml to Rs 110.54 ml. but the slow growth rate of 7.88 percent in advance against 25 percent growth rate for deposits has forced its C/D ratio to decline sharply from 63.63 percent to 28.69 percent thereby registering a negative growth of -14.30 percent. The two growth rates (deposit outstanding and C/D ratio) in opposite direction raise a fundamental question with regard to the very basic role of the rural bank to extend credit facility for fostering the economic development in its operational area. While addressing to this fundamental role, it seems the bank is confronted with another pertinent issue that deals with its survival as a financial institution. The gravity of this threat is well evident in its average NPA of 52.02 percent and recovery rate 18.66 percent over the past few years. Pressed in between the question of role and survival, the bank has chosen a safe strategy by devising a low fixed return biased investment policy (portfolio is biased towards SLR and Non-SLR securities). As a consequence, the profitability position of the bank has emerged as a casualty. Over the period under study the bank's average profit and the average accumulated loss have been recorded at Rs1.2 ml and Rs. 88.05 ml respectively. The accumulated loss figure which was consistently increasing over the years to reach at Rs. 143 ml in the year 1996-97 assumed a reversal trend for the subsequent years during which the bank registered moderate profit. One of the major factors contributing to its precarious profitability position is the dominance of priority sector loans in its total loan portfolio. However, the decline in the share of priority sector loan from more than 90 percent to 44 percent over the period against the RBI prescribed limit of 40 percent provides evidence to observe that the bank is now canalizing its resources to other profitable sectors where return is assured or comparatively high. Table 2 depicts the overall picture of the bank to support the above analysis.

Profitability at Corporate Level — A Causation Analysis

Several efficiency variables have bearing on the profitability of a banking institution. Among the major variables; the interest margin, loan quality and overheads; (Rangarajan, 1993), spread i.e. net interest income to total assets, (Ram Mohan Rao, 2002); costs of default, administration costs and dependence on subsidies (Chavan & Ramkumar, 2002) are some of the widely used measure of efficiency in banking.

Another accepted measure of profitability used by banking institutions is the ratio of net profit to the working fund (NPWF)⁴. The profitability of SGB as reflected through this ratio reveals a sordid picture of the overall performance of the bank. In this section, through multiple regression analysis an attempt has been made to identify the functional relationship of important corporate level variables (independent) with the dependent variable (NPWF). The important independent variables identified

4. This ratio indicates how efficiently the bank has utilized its available fund. Thus the total working fund for the bank has been calculated by taking the aggregates of total deposits outstanding and total borrowings made by the bank at corporate level.

Table 2
Selected Indicators of SGB (1991-92 to 2000-01)

Year	Deposits	Loan	C/D Ratio	Investment to Deposit Ratio	NPA	Recovery	Priority Sector advance to Total Loan	Profit	Accumulated loss	Profit as % of working Fund
	Rs. ml.	Rs. ml.%		%	%		Rs. ml.	Rs. ml.		
1991-92	112.84	71.47	63.63	40.56	-	-	91.21	-8.00	23.13	-4.63
1992-93	122.67	84.10	68.56	25.56	-	22.92	90.78	-10.53	33.66	-5.39
1993-94	176.33	92.88	52.68	36.65	-	18.44	90.44	-17.55	51.21	-5.00
1994-95	248.66	101.97	41.00	47.93	-	12.33	88.48	-16.21	67.42	-4.31
1995-96	293.60	107.52	36.62	48.35	-	6.59	85.21	-25.42	92.84	-5.16
1996-97	324.56	114.04	35.13	69.07	71.04	17.98	77.96	-50.19	143.03	-0.41
1997-98	446.75	110.59	24.76	77.77	64.43	18.45	73.56	6.51	136.52	1.42
1998-99	600.61	124.43	20.72	73.28	52.88	16.31	63.29	17.7	118.82	2.88
1999-00	737.42	136.00	18.44	73.02	39.383	36.30	52.10	7.43	111.39	0.99
2000-01	780.41	162.39	20.81	77.93	31.91	-	44.53	8.78	102.61	1.47
Avg.	384.38	110.54	28.69	66.63	52.02	18.66	72.33	-9.95	88.06	-0.29
Growth Rate	25.86	7.88	-14.30	40.79	-18.80	19.44	-0.15	10.02	18.89	-

Source: Compiled from Annual Reports of SGB

are interest paid to working fund (IPWF), interest received to working fund (IRWF), operating expenses to working fund (OEWf), credit-deposit ratio (CDR), ratio of priority sector lending to total lending (PSLR), the rate of recovery of loan (ROR) and staff productivity (SP). A step-wise regression has been run by incorporating the data for ten years i.e., from 1991-92 to 2000-01.

The model specifications:

Models:	Constant	b	R	R ²	F Ratio
1. NPFw =	-6.897 + (-5.67)*	.194 SP (4.74)*	.858	.737	22.48*
2. NPFw =	-13.30 + (-5.69)*	.134SP + .919 IRWF (3.78)* (2.95)**	.939	.883	26.42*
3. NPFw =	2.12 + (.47)	.067 SP + 1.52 IRWF - 3.28IPWF (2.38)*** (5.98)* (-3.57)**	.981	.963	51.49*

* Significant at 1% level of significance

** Significant at 5% level of significance

*** Significant at 10% level of significance

(Figures in bracket indicate t value)

The step-wise regression result reveals that staff productivity, interests received to working fund ratio and interests paid to working fund ratio are the strong predictors in the model. The relationship between the dependent variable and independent variables as indicated by Karl Pearson's coefficients hold sound theoretical explanation. Theoretically, net profit to working fund ratio shows positive relationship with staff productivity and interest received to working fund and negative relationship with interest paid to working fund. The high degree of coefficient of determination, significant t-values along with significant F Ratios validate the explanatory power of the model. Further, the Durbin Watson ratio of 2.463 negates significant auto-correlation in the data.

Analysis at Branch Level

To provide an insight into the branch-level performance of RRBs, all the 16 branches of SGB in Lakhimpur district have been considered for analysis. For this purpose data for eight years i.e., from 1993-94 to 2000-01 has been collected from the relevant branch records. This analysis tries to identify the most important indicators on the basis of which the overall performance can be judged. The overall performance of these branches is reflected in the net spread ratio i.e. net spread to total deposit outstanding ratio (NSTD)⁵, the final ratio, that depends on many other intermittent variables viz. credit-deposit ratio (CDR), the ratio of non-performing assets to total assets (NPATA), total income to

5. Since there is no borrowings at the branch level total deposits outstanding has been considered for the purpose of the calculation of profitability indicator.

total deposit outstanding (TITD) and operating expenditure to total income (OETI)⁶. The C/D ratio gives an idea of the relative volume of business on a capital base and larger the ratio higher is the spread. Thus, it is expected that there should be a positive correlation between the two variables. The second ratio reflects the quality of assets, which ultimately decides the bottom line. The proportion of NPA reflects poor recovery, which in turn affects the spread. Since there is an inverse relationship between NSTD and NPA, the correlation coefficient is expected to be negative. The third ratio indicates the rate of return on capital employed (deposit outstanding) at branch level and higher the total income better is the return on capital. With the increase of this ratio the net spread ratio should also increase, and thus a positive correlation is expected. The last one indicates the share of operating expenditure in the total income, giving an idea of the efficiency of the management to control operational expenditure. The correlation of net spread with this ratio is negative because of the inverse relationship between operating expenditure and the net spread.

Considering the above theoretical relationship, the correlation coefficients between net spread and four intermittent variables have been calculated and presented in the Table 3. It is found from the table that for most of the branches there is a strong negative relationship between net spread ratio to

Table 3
Correlation of Important Indicators

Sl. No.	Branch Name	Correlation of NSTD to			
		CDR	NPATA	TITD	OETI
1	North Lakhimpur	-0.39	-0.14	0.83	-0.80
2	Nakari	-0.94	-0.89	-0.19	-0.45
3	Dholpur Tinali	-0.44	-0.59	0.60	-0.72
4	Bahapati	-0.78	-0.92	0.66	-0.74
5	Bhogpur Chariali	-0.77	-0.69	0.67	-0.88
6	Harmoti	-0.96	-0.86	0.51	-0.87
7	Bihupuria	-0.80	-0.44	0.48	-0.92
8	Narayanpur	-0.35	-0.73	0.89	-0.79
9	Lialbari	-0.72	-0.28	0.97	-0.87
10	Pahumora	-0.72	-0.69	0.69	-0.73
11	Dejoo	-0.72	-0.69	0.94	-0.97
12	Laluk	-0.37	-0.90	0.30	0.02
13	Borbali	-0.81	-0.45	0.83	-0.99
14	Dhakuakhana	-0.73	-0.82	0.58	-0.60
15	Sonari Chapori	-0.18	-0.63	0.92	-0.93
16	Panigaon	-0.96	-0.98	0.55	-0.98

6. These indicators figure prominently in the survey undertaken to know the important factors, which affect the branch-level profitability. Figures against each indicator for the branch are calculated on the basis of their average figures for the last 8 years except for the second where it is calculated on the basis of average of 5 years due to the non-classification NPA in the earlier years.

C/D ratio (average correlation coefficient is -0.66 with the coefficient of variation 33 percent). The high order of negative correlation coefficient is due to simultaneous effect of decline in C/D ratio and improvement in net spread that has emerged out of the policy alternation to park a major chunk of its funds in SLR and non-SLR securities. For the second ratio (NPATA) negative relationship has been found and the degree of relationship as measured by Karl Pearson's coefficient ranges between -0.14 to -0.98 with an average of -0.65 and coefficient of variation at 39 percent. for different branches. This reflects that the decline in NPA has helped the branches to improve their spread. The average correlation coefficients computed to show the degree and direction of relationship of the TITD and OETI ratio with NSTD are 0.61 and -0.73 with coefficient of variation at 53 percent and 37 percent respectively. The moderate correlation coefficients indicate the possibility of those parameters to act as predictors to determine the profitability at the branch level. However, the high order of coefficients of variation need to be noted to indicate the wide variation across the branches regarding relationship established between NSTD and other selected parameters.

Considering the above important parameters a regression has been run to identify the explanatory variables of the profitability indicator i.e. net spread to total deposit (NSTD). Through the step-wise regression two variables namely, return of total income on total deposit outstanding (TITD) and the share of operating expenses to total income (OETI) are found to be the significant predictor variables which explain the profitability indicator.

Models:	Constant	b	R	R ²	F Ratio
1. NSTD =	5.065 (6.132)*	-.13 OETI (-8.591)*	.917	.84	73.81*
2. NSTD =	9.628 (6.92)*	-.133 OETI (-12)*	.960	.921	75.77*
		-.405 TITD (-3.64)*			

* Significant at 1% level of significance
(Figures in bracket indicate t value)

The regression results both at corporate and branch level reveal interest income, as one of the most important variables affecting the profitability of SGB. Since interest income constitutes more than 90 percent of the total income of the bank, its associate variables like recovery ratio and non-performing/total assets ratio are thus considered to be important predictors of profitability. Besides, the operating expenses to total income ratio is found to be another variable for the regression model to predict the profitability at branch level.

On the basis of the above described four parameters (credit-deposit ratio, non-performing assets to total loan assets ratio, total income to deposit outstanding ratio and operating expenditure to total income ratio) of branch level performance it is now possible to classify all the sixteen branches in order of their performance. Although all the parameters are important for the overall profitability performance, banks may assign differential priority on them depending on their own objectives and situation. In order to arrive at the weight that should be assigned to the individual parameters, expert opinion method has been followed involving all the concerned branch managers and ten academic experts in the subject.

Measuring all the four parameters on a 10-point scale and assigning the average weights in the ratio 15:35:15:35 in their respective order the weighted average score for each branch was computed

to classify all the branches in the following four categories according to the quartile limits.

Score between 7.5-10	Leading branch (2)
Score between 5- 7.5	Starting to Catch branch (11)
Score between 2.5-5	Crawling branch (3)
Score below 0-2.5	Non starters (0)

Table 4
Overall Performance of Different Branches

Sl. No.	Branches	Weighted Score				Total Weighted Score
		C/D Ratio	NPA to Total Deposit	Interest Income to Total Deposits	Operating Expenditure to Total Income	
1	North Lakhimpur	0.6	1.4	0.6	3.5	6.1
2	Nakari	1.2	2.8	0.6	3.5	8.1
3	Dholpur Tinali	1.5	3.5	0.3	2.1	7.4
4	Bahapati	1.5	2.1	0.3	1.4	5.3
5	Bhogpur Chariali	0.6	2.8	0.3	3.5	7.2
6	Harmoti	1.5	2.8	0.6	2.1	7
7	Bihupuria	1.5	2.8	0.3	2.1	6.7
8	Narayanpur	1.2	3.5	0.3	2.8	7.8
9	Lialbari	1.2	2.1	0.3	0.7	4.3
10	Pahumora	1.5	2.8	0.3	1.4	6
11	Dejoo	1.2	2.8	0.3	2.8	7.1
12	Laluk	0.6	2.1	1.5	2.1	6.3
13	Borbali	1.2	2.8	0.3	2.8	7.1
14	Dhakuakhana	0.3	1.4	0.3	1.4	3.4
15	Sonari Chapori	1.2	2.8	0.3	0.7	5
16	Panigaon	0.6	2.8	1.2	2.8	7.4

The number of branches as indicated in the brackets portrays that nearly 70 percent of the total branches in the district have started to catch the performance line set by the leading branches. The necessity that arises at this juncture is to provide the right direction and opportunity to function with innovative ideas.

Strategic Measures for Revival

The findings of the above statistical analysis and interview with branch and corporate level managers reveal that the bank is plagued with low profitability due to unprofitable fund deployment, increased

operating expenditure and inordinate non performing asset. Remedial strategic measures need to be introduced in order to bring the bank back on the track of efficiency and enable to compete in a liberalized economy. The following are some strategic measures of worth consideration.

Operating Cost Control

It is observed that the high ratio of operating expenditure to other expenditure has affected the profitability of RRBs. This has been more than 40 percent for most of the RRBs. Salary and other allowances to staff members and maintenance of office constitute the largest chunk of this expenditure. In this regard operational target could be fixed with the help of zero-based budgeting. Further, automation of operation at branch level could also help in containing the office expenditure to a great extent.

It is found that in many areas branches of both RRBs and of public sector bank are operating. Since the public sector commercial banks enjoy a greater public confidence, the business of the former gets a setback. As evident in RBI database, public sector banks have extended nearly 50 percent of total rural credit, where as RRBs only have just over 8 percent. It is also found that the branches of the sponsor bank of the same RRB are also functioning in one area. Thus the clash in operational areas between RRB and sponsor commercial bank leads to market cannibalization and results in detrimental effect on the business of the former. To tackle the above problem at micro level restructuring strategies like branch consolidation, branch re-location and even branch closure may be considered as appropriate measures. Merger of RRBs on a selective basis only with the acceptance of all stakeholders as suggested by recent expert committee on rural credit (NABARD, 2001) and transforming strong RRBs into local area banks (LABs)⁷ (Satyasai & Patil, 2002) are potential options to work well at the macro level.

Efficiency in Loan Recovery

Not only in the case of SGB but also for the entire Indian banking sector, poor recovery of loan has emerged as a constant problem to contribute to the cause of low profitability. Despite several policy measures and prescriptions initiated by GOI and RBI, the recovery remains grim as it was during pre-liberalized era. It was a general feeling that after liberalization things would improve but the blockage of more than Rs. 550.00 billion of commercial bank's credit (including Rs. 28 billion of rural bank's credit) in the Indian banking system is a testimony of the inefficient loan recovery management. "The root problem is that there is a sizeable overhang composition arising from the weak debt recovery process, inadequate legal structure, weakness in underlying security, inadequate risk management techniques, etc" (Bidhe, *et.al.* 2002:402-403). Further it seems that the borrowers have learned many innovative ways of playing safe with bank borrowings.

Any strategy for good recovery should be considered taking into account the efficiency of loan appraisal and credit delivery system. The screening problem can be tackled by abandoning direct

7. Local Area Banks are envisaged as private enterprise in rural localities for mobilizing rural saving and making them available for investment locally (Shivamaggi 2000: 1718).

interest rate subsidies, so that the borrowers take loan on the basis of prospective returns and not simply to capture subsidies; by providing loans for 'fail-safe' technical packages, fertilizer or milch cow rearing, that 'cannot go wrong'; by using borrowers groups to screen for both character and proposed loan use; or by using local power structures so that senior local officials have to approve loan application. (Hume & Mosley, 1996, P. 8) The 'incentive to repay' problem can be approached by the use of either sticks (intensive loan monitoring and supervision, either directly by the lender or indirectly through joint liability groups) or carrots (offering progressively larger loans for good borrowers or rewards to borrowers, bank staff, even local officials, for achieving repayment targets). If all else fails, compulsory savings schemes can be developed alongside the credit operations, which will partially insure the lender against default. (*op.cit.*: 8). "Recovery is dependent upon lender-borrower relationship and assurance to the latter that repayment provides better access to credit" (Rao. et.al 1999-2000:379). The building of customer relations is thus more important than mere follow-up and monitoring. To begin with the loan appraisal system, proper training to at least one staff per branch is highly essential and the branch manager should have enough power to decide about the loan application irrespective of the amount involved.

For credit delivery, voluntary agencies like Non-Government Organizations (NGO), Self Help Organizations (SHO) etc. could provide a yeoman's service. These organizations can bring about a qualitative change in the rural credit delivery system particularly in relation to the poorer segments (Rangarajan 1994: 1059). The experience of India and in other countries, where voluntary agencies have provided such service, shows that where these agencies have been able to provide assistance to borrowers, disbursements are much faster and by timely disbursements it is possible to also ensure effective loan recoveries (Tarrapore 1994). Loan recovery performance should be recognized as a strategic intervention for higher profitability... rather than of lukewarm response to all options (Pati 1999: 857). Among other techniques, profit sharing by the employees of the rural financing institutions and social cohesiveness in rural lending with peer group pressure to bring about a total aversion to loan defaults could also be tried in different situations. Organizing loan recovery camps with the associations of Gram Panchayat and village development councils/committees could also bring some positive result in this direction.

Encashing Legal Environment for NPA Management

Among all the contributory factors "the major drag on the profitability of banks is the high level of non-performing assets" (Rangarajan, 1994, p-1050)*. The menace of NPA has been spreading like wild fire and the entire financial sector is sick of it.⁸ As an offshoot of bad recovery, the presence of huge NPA and their management has been the biggest headache of Indian banking system. So far as the RRBs are concerned the occurrence of NPA is more likely because of their large exposure to priority sector lending, which is dominated by small and marginal borrowers in agriculture and allied sectors. "While priority sector lending may not be the primary source of weakness in banks' assets portfolio, it

8. As per the estimate of the consultancy firm Ernest & Young, the NPAs of Indian banks and financial institutions stand at \$25 billion (about Rs.1230 billion) against the RBI estimate of \$16.7 billion in its last annual report. Out of this huge amount Indian public sector banks alone accounts for Rs. 547.73 billion as on 31st March 2001 (Business Standard, 12.07.02, p-11).

is no great source of balance sheet or earning virtue either. If the government wishes to persist with the policy of requiring stated proportion of credit to go to priority sector, it must remove the price caps that it has simultaneously imposed" (Chaudhuri 2002: 2161) To tackle the growing menace of NPA in Indian financial sector, in recent years serious attempts have been made. Among them the establishment of Debt Recovery Tribunals (DRTs), tightening of provisioning norms for various categories of assets etc. are prominent. But the recent Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Ordinance, 2002 promulgated on June 21, 2002 has given wide authority to banks to deal with NPA⁹. Now they can change or take over the management, they can sell or lease out the business of the borrower; they can take possession of all the secured assets; and they can also reschedule the payment of debt by the borrowers. Besides, the ordinance has the provision of establishing Assets Reconstruction Company (ARC) to take over the contaminated portfolio of banks at a discount and thus help in cleaning-up their balance sheets. The ARC option is however will not come into the rescue of RRBs because of the prevalence of small amount loan in their portfolio. The local initiatives like collaboration with village bodies and micro financing through SHOs could yield better results for these rural financing institutions. While it is imperative that in an economy like ours, money has to be dovetailed to agriculture and RRBs will need to play a crucial role in this regard, it would be more appropriate to have directed lending on commercial terms, and not directed, subsidized lending. (Bidhe et.al. 2002: 403). In the wake the recent change in the legal environment the RRBs now have to take initiatives to pull the NPA level to a minimum and prevent any further deterioration therein.

Innovative Restructuring

So far restructuring of banks are concerned; recapitalisation, closure of bank/branch, merger and relocation of branches are some of the strategies, which can be thought of. Ever since the restructuring of public sector banks through infusion of fresh capital to deal with bank revival started in the year 1985-86, several million of rupees have flown to different public sector banks including RRBs. But there has not been any significant improvement in their profitability parameters. Thus, it would be pertinent at this juncture to sound a note of caution. While recapitalisation of banks is necessary condition for dealing with weaknesses in the banking industry, it is, by no means, a sufficient condition (Honohan, 2001). It also highlighted that the experience of bank recapitalisation does not necessarily prevent banks from getting into trouble again. In fact, it often serves to distort the incentive structure, erode discipline and reaffirm the faith of these institutions in the 'deep pockets' of the government (RBI, 2001,p-24). However, because of national interest if any RRB has to be saved from closure by means of a recapitalisation strategy, it must be done on a selective basis and implemented through a new team of management with dynamism and excellent track record. At micro level a bank can also adopt the same strategy when it is the case of one of its branches.

Operational autonomy in credit decision-making and in matters of internal organization and management is one of the critical elements of organizational reform to gain competitive advantage. The branch level managers should get enough power to decide about the range and variety of products,

9. This ordinance has been recently passed in the parliament (Economic Times 22.11.2002: 1) and as per some data 25 public sector banks and financial institutions have send notice to recover Rs. 32.6 billion and Rs.36 billion from different borrowers by invoking the new ordinance (Economic Times, 27. 11.2002: 13)

loan application and the re-schedulement of the installments as and when necessary. Devolution of power will not only facilitate realistic target setting for busy season and lean season but also reduction of NPA through improved recovery.

Epilogue

The wind of liberalization has transformed the Indian banking sector into a new height. It has unleashed many opportunities for the banks and also simultaneously posed serious challenges to their survival. The viability of banks are growingly depending upon the ability to cope-up with the challenges by providing optimum customer satisfaction through just-in time solutions, by containing operating expenses and improving the quality of portfolios. As rural financing institutions, the viability of RRB's has also been under constant pressure. The responsibility of catering to the need of rural masses and at the same time competing with other commercial banks, have put them in a piquant situation. The poor recovery of rural loans and growing operating expenditure are the main stumbling blocks for their growth in profitability. There is thus a need that age old practice and standards must be improved upon and RRBs should reorient their focus to market related considerations. Every effort has to be made by RRBs in line of the offered suggestions to improve their portfolio quality and to arrest further slippage of assets to NPAs. Intensive loan collection and incentives for borrowers and staff can be resorted to improve the bottom line. The shape of the future performance of RRBs will much depend on their ability to manage the transition by means of an approach that is customer driven and technology-oriented.

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524 Asian Profile

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