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Performance of RRBs Before and after Amalgamation

DR. MINAXI M. JARIWALA
Lecturer,
Vivekanand College for B.Ed.
Gujarat (India)

DR. MARTINA R. NORONHA
Vice-Principle
S.P.B. English Medium College of Commerce
Gujarat (India)

Abstract:
The large scale persistence of rural poverty even after the first two decades of planning made the planners realize that achieving faster economic development alone may not bring about any significant reduction in rural poverty. The realization was based on the view that percolation of the benefits of growth to the rural poor has been hindered to a great extent by the existing inequitable distribution of productive resources like land and capital. Several policy initiatives were taken to ensure an easy flow of credit to the rural poor. The creation of regional rural banks (RRB$_S$) in 1975 to cater exclusively to the credit needs of rural poor like small and marginal farmers, rural artisans and agricultural laborers was one such initiative. The Institution of RRB$_S$ was created to meet the excess demand for institutional credit in the rural areas, particularly among the economically and socially marginalized section although the co-operative banks and the commercial banks had reasonable records in terms geographical coverage and disbursement of credit. In terms of population group, the co-operative banks were dominated by the rural rich, while the commercial bank had a clear urban bias. In order to provide access to low cost banking facilities to the poor rural banking in India was started. Rural banks in those days mainly focused upon the agro sector. RRBs in India penetrated every corner of the country and extended a helping hand in the growth process of the country. It was envisaged to combine desirable qualities of co-operative banks and commercial banks in RRBs at the same time. It was emphasized that the role of RRBs would be to supplement and not supplant other institutional agencies already existing in the field. The Internal working group of the Reserve Bank of India (RBI) suggested that merger and amalgamation of Regional Rural Banks (RRBs) may help in improving their health and viability, even as it sought to bring in new banks both public and private as sponsors of the merged RRBs.

Keywords: *Amalgamation, Banking, Co- Operative bank, Commercial bank, Rural bank, RRB$_S$*

1. Introduction

The large scale persistence of rural poverty even after the first two decades of planning made the planners realize that achieving faster economic development alone may not bring about any significant reduction in rural poverty. The realization was based on the view that percolation of the benefits of growth to the rural poor has been hindered to a great extent by the existing inequitable distribution of productive resources like land and capital. Several policy initiatives were taken to ensure an easy flow of credit to the rural poor. The creation of regional rural banks (RRB$_S$) in 1975 to cater exclusively to the credit needs of rural poor like small and marginal farmers, rural artisans and agricultural laborers was one such initiative. The RRB$_S$ came into being mainly as a sort of via media between the commercial bank and co-operatives which had for long neglected the rural poor for various reasons. They were expected to serve the rural poor by combining in them local feel of and familiarity with rural problems which the co-operative have and the managerial and business abilities possessed by the commercial bank. The Institution of RRB$_S$ was created to meet the excess demand for institutional credit in the rural areas, particularly among the economically and socially marginalized section although the co-operative banks and the commercial banks had reasonable records in terms geographical coverage and disbursement of credit. In terms of population group, the co-operative banks were dominated by the rural rich, while the commercial bank had a clear urban bias. In order to provide access to low cost banking facilities to the poor rural banking in India was started. Rural banks in those days mainly focused upon the agro sector. RRBs in India penetrated every corner of the country and extended a helping hand in the growth process of the country. It was envisaged to combine desirable qualities of co-operative banks and commercial banks in RRBs at the same time. It was emphasized that the role of RRBs would be to supplement and not supplant other institutional agencies already existing in the field.

Table 1

State Wise Distribution of RRBs. (As end of March 2005)

State	No. of RRBs.
Andhra Pradesh	16
Arunachal Pradesh	01
Assam	05
Bihar	22
Chhattisgarh	03
Gujarat	09
Haryana	04
Himachal Pradesh	02
Jammu and Kashmir	03
Jharkhand	02
Karnataka	13
Kerala	02
Madhya Pradesh	19
Maharashtra	10
Manipur	01
Meghalaya	01
Mizoram	01
Nagaland	01
Orissa	09
Punjab	05
Rajasthan	14
Tamil Nadu	03
Tripura	01
Uttar Pradesh	36
Uttrakhand	04
West Bengal	09
Total	**196**

Table 2

State Wise Distribution of RRBs. (As end of March 2009)

State	No. of RRBs.
Andhra Pradesh	05
Arunachal Pradesh	01
Assam	02
Bihar	04
Chhattisgarh	03
Gujarat	03
Haryana	02
Himachal Pradesh	02
Jammu and Kashmir	02
Jharkhand	02
Karnataka	06
Kerala	02
Madhya Pradesh	08
Maharashtra	03
Manipur	01
Meghalaya	01
Mizoram	01
Nagaland	01

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State	No. of RRBs.
Orissa	05
Pondicherry	01
Punjab	03
Rajasthan	06
Tamil Nadu	02
Tripura	01
Uttar Pradesh	12
Uttrakhand	02
West Bengal	03
Total	**84**

2. Restructuring of RRBs

The financial viability of RRBs has engaged the attention of the policy makers from time to time. In fact, as early as 1981, the Committee to Review Arrangements for Institutional Credit for Agriculture and Rural Development (CRAFICARD) addressed the issue of financial viability of the RRBs. The CRAFICARD recommended that 'the loss incurred by a RRB should be made good annually by the shareholders in the same proportion of their shareholdings. Though this recommendation was not accepted, under a scheme of recapitalization, financial support was provided by the shareholders in the proportion of their shareholdings. Subsequently, a number of committees have come out with different suggestions to address the financial non-viability of RRBs. For instance, the Working Group on RRBs (Kelkar Committee) in 1984 recommended that small and uneconomic RRBs should be merged in the interest of economic viability. Five years down the line, in a similar vein, the Agricultural Credit Review Committee (Khusro Committee), 1989 pointed out that 'the weaknesses of RRBs are endemic to the system and non-viability is built into it, and the only option was to merge the RRBs with the sponsor banks. The objective of serving the weaker sections effectively could be achieved only by self-sustaining credit institutions'. The Committee on Restructuring of RRBs, 1994 (Bhandari Committee) identified 49 RRBs for comprehensive restructuring. It recommended greater devolution of decision-making powers to the Boards of RRBs in the matters of business development and staff matters. The option of liquidation again was mooted by the Committee on Revamping of RRBs, 1996 (Basu Committee). The Expert Group on RRBs in 1997 (Thingalaya Committee) held that very weak RRBs should be viewed separately and possibility of their liquidation be recognized. They might be merged with neighboring RRBs. The Expert Committee on Rural Credit, 2001 (Vyas Committee I) was of the view that the sponsor bank should ensure necessary autonomy for RRBs in their credit and other portfolio management system.

The Internal working group of the Reserve Bank of India (RBI) suggested that merger and amalgamation of Regional Rural Banks (RRBs) may help in improving their health and viability, even as it sought to bring in new banks both public and private as sponsors of the merged RRBs. In order to give a further boost of profitability of these banks and to strengthen them further, a need was felt to amalgamate more than one RRB of same sponsor bank operating in the same state. There were 196 Regional Rural Banks operating in the country as on March 31, 2004 which included 51 standalone RRBs. Most of the sponsor banks were operating more than one RRB in one State which resulted in more operational expenditure. The group suggested two options for mergers/amalgamation: merger between RRBs of the same sponsor bank in the same State and merger of RRBs sponsored by different banks in the same State. The group noted that merger of RRBs with the sponsor bank is not provided for in the RRB Act, 1976, and that such mergers would go against the spirit of setting up RRBs as local entities and for providing credit primarily to weaker sections. There were 33 RRBs having operational losses as on March 31, 2004 and to overcome the operational problems, reduce expenditure, enhance operational efficiency, etc, the Reserve Bank of India decided in August 2004 that all RRBs sponsored by a bank and operating in one state should be amalgamated into single entity. This decision was more relevant in the fast changing environment in banking with introduction of more and more new financial products necessitating RRBs to grow bigger. Moreover, in the changed scenario, computerization and volume were considered key to success for these entities

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which is feasible and viable only when RRBs are big in size. The merged entities and the existing RRBs that have accumulated losses can be capitalised to wipe out the loss and satisfy the minimum capital requirement. The additional capital can be subscribed in the same proportion as the issued capital by the different stakeholders, are provided in the RRB Act, 1976. The group observed that RRBs could be advised to maintain a desirable level of capital adequacy. However, it is felt that while RRBs are required to maintain CRAR, the ratio may not be as high as that of commercial banks and may be initially kept at 5 per cent as about 100 RRBs are falling short of 5 percent CRAR. The process of Amalgamation was started in early 2005and first set in September, 2005. As on March 31, 2007 145 RRBs was amalgamated and 45 new entities emerged reducing total RRBs from 196 to 96 and further to 88 at the end of June 2008. This included 45 amalgamated banks 42 stand alone banks and one new bank (puduvai Bharathiar Grama) Bank with jurisdiction over the union Territory of Pondicherry). The process of amalgamation resulted in 84 RRBs as on January 1, 2010.

Table 3. Financial performance of RRBs before and after Amalgamation (t-test Results of Capital Composition)

Amalgamation Period	μ	Variance	Observation	| t |	$t_{0.05}$	H_0 R/A
Before	9936.5	1325264.75	4	4.019	2.353	R
After	18721.25	13009595.68	4			

The result from the Table 3 indicates that the calculated value of statistics $|t| = 4.019$ is greater than the table value $t_{0.05,3} = 2.353$. So, H_0 is rejected at 5% level of significance which signifies that there is difference in capital composition of RRBs due to amalgamation. Both owned funds and borrowed funds have constantly increased over the period of study. It can be observed from the above table that borrowed funds constitute a greater percentage than the owned funds during the post amalgamation period.

3. Deposits Mobilization

RRBs are expected to mobilize resources from rural areas and play a significant role in developing agriculture and rural economy by mobilizing resources in rural sectors for the needy. The business performance of RRBs in terms of Deposits mobilization is presented in Table 4.

Table 4. Deposits

Years	Deposits (in ₹)
2001-02	44539
2002-03	50098
2003-04	56350
2004-05	62143
2005-06	71329
2006-07	83144
2007-08	99093
2008-09	120189

RRBs have shown considerable improvement in deposits mobilization in Table 4.
H_0 - There is no change in Deposits of RRBs due to amalgamation
H_1 - There is change in Deposits of RRBs due to amalgamation

Table 5. t-test Results of Deposit Mobilization

Amalgamation Period	μ	Variance	Observation	| t |	$t_{0.05}$	H_0 R/A
Before	**24942.75**	**4**	**4**	**3.4693**	**2.353**	**R**
After	**53748**	**4**	**4**			

The test results are given in Table 5. The calculated value of statistics $|t| = 3.4693$ is greater than the table value $t_{0.05,3} = 2.353$. So, H_0 is rejected at 5% level of significance which means that there is difference in Deposits of RRBs after amalgamation. The deposit mobilized by the bank has increased from 44539 crores in the year 2001-02 to 120189 crores in 2008-09. The increase over the period was 2.7 times.

4. Investment

Investment as window of deployment of funds is given more emphasis than lending. Growth of Investment is important for stability of any bank. The business performance of RRBs in terms of Investments is presented in Table 6.

Table 6
Growth of Investments

Years	Amount of Investment (` in crores)	% Increase over previous year
2001-02	30532	----
2002-03	33063	8.28
2003-04	36135	9.29
2004-05	36762	1.73
2005-06	41182	12.02
2006-07	45666	10.88
2007-08	48560	6.33
2008-09	65910	35.72

There has been consistent growth in the sphere of Investment activity. It has been observed that the amount of Investment of the bank has increased from 30532 crore in the year 2001-02 to ₹ 65910 crore in 2008-09. The year 2008-09 registered the highest growth of Investment of 35.72% over the previous year.

5. Sector wise Loan Disbursement

Before the initiation of banking reforms, lending from the RRBs was largely restricted to the priority sector. From September 1992 onwards, RRBs were allowed to finance non-target groups to the extent not exceeding 40 percent of their incremental lending. This limit was subsequently enhanced to 60 percent in 1994. As a result the RRBs diversified into a range of non-priority sector (NPS) advances, including jewel and deposit linked loans, consumer loans and home loans. Priority Sector is a sector which is given priority in offering financial services by the banks. The concept of priority sector was first brought into the financial system in 1968, when the government imposed social control over the banks. Banks are directed to lend a certain percentage of loans to the sector listed in the priority sector. In 1968, three sectors namely agriculture, small industry and exports were treated as priority sector. Gradually, the list of segments under priority sector increased. At present it consist of agriculture, small scale industry, small transport operators, exports, small business housing, self employed persons, professionals, education. Recently, micro finance through self-help group (SHG) is also included in priority sector.

Table 7. Sector wise Loan Disbursement

Years	Priority Sector (₹ in crores)	% to total loans	Non-priority Sector (₹ in crores)	% to total loans	Total Loans (₹ in crores)
2001-02	9640	77.49	2801	22.51	12441 (100%)
2002-03	10096	79.87	2545	20.13	12641 (100%)
2003-04	12731	81.72	2848	18.28	15579 (100%)
2004-05	16724	79.33	4358	20.67	21082 (100%)
2005-06	20471	80.87	4842	19.13	25313 (100%)
2006-07	27155	82.18	5888	17.82	33043 (100%)
2007-08	31984	82.90	6598	17.10	38582 (100%)
2008-09	36125	93.30	7242	16.70	43367 (100%)

Source: Central Statistical Information Department, NABARD.

H_0 - There is no difference in the disbursement of loans to priority sector of RRBs after amalgamation
H_1 - There is difference in the disbursement of loans to priority sector of RRBs after amalgamation

Table 8. t-test Results of Sector wise Loan Disbursement

Amalgamation Period	μ	Observation	$\lvert t \rvert$	$t_{0.05}$	H_0 R/A
Before	2012.13	8	4.5378	2.977	R
After	5010	8			

Table 8 provides the result that there is strong evidence that the calculated value of statistics | t | = 4.5378 is greater at 5% level of significance which means that there is difference in the disbursement of loans to priority sector of RRBs due to amalgamation. Table 7 reveals year wise loans issued to both priority and non-priority sectors by RRBs. It is important to observe from the table that the loans issued to priority sectors constitute a greater percentage than the loans provided to the non-priority sector. Loans to the priority sector have increased from 77.49% in 2001-02 to 83.30% in 2008-09.

6. Disbursement of loans to various groups in the priority sector

Rural Credit policy in India envisaged the provision of a range of credit services, including long-term and short-term credit loans to rural community. During the operation of three decades, the RRBs in India have recorded a significant growth in the disbursement of loans to priority sector. Table 9 depicts the loans issued to various groups in the priority sector.

Table 9

Disbursement of loans to various groups in the Priority Sectors

Years	Rural Artisans (RA) (` in crores)	Small Scale Industry (SSI) (` in crores)	Retail Trade (RT) (` in crores)	Self – Help Group (SHG) (` in crores)	Other Priority Sector (OPS) (` in crores)
2001-02	181	70	1123	310	8102
2002-03	236	138	1421	350	819
2003-04	276	167	1653	510	1941
2004-05	316	210	1967	858	1290
2005-06	304	342	1841	1171	2282
2006-07	320	342	1984	1406	2222
2007-08	326	638	2024	2107	2775
2008-09	552	670	2370	2388	3662

Source: Central Statistical Information Department, NABARD

H_0 - Disbursement of loans to various priority sector by RRBs is equal

H_1 - Disbursement of loans to various priority sector by RRBs is not equal

Table 10. Test Result for Disbursement of loans to various groups

Groups	Count	Sum	Average	Variance
Loans to RA	8	2513	314.125	10263.81
Loans to SSI	8	2577	322.125	47173.48
Loans to RT	8	14383	1797.875	90253.9
Loans to SHG	8	9100	1137.50	595184.2
Loans to OPS	8	15793	1974.125	875620.3

Table 11. ANOVA Test Result for Disbursement of loans to various groups

Source of Variance	SS	Df	MS	F	$F_{0.05\ (4.33)}$	H_0 R/A
Between groups	10130087.64	4	253252.91	3.85	2.6896	R
Within groups	21702064.46	33	657638.32			
Total	**31832152.1**	**37**				

According to the Table 11, F-Statistics is more than the critical value; we reject the null hypothesis that loans disbursed to all the groups in the priority sector loans are equal. Likewise all the groups show an increasing trend over the period of the study. It has been observed from the Table 9, that the loans provided by the RRBs to various groups have been increasing year after year. The loans to rural artisans have increased from ₹181 crores in 2001-02 to ₹ 552 crores in 2008-09. The increase over the period was 2.3 times. The loans to small scale Industry have increased from ₹ 70 crores in 2001-02 to 670 crores in 2008-09. The loans to Retail Trade (RT) have increased from 1123 crores in 2001-02 to 2370 crores in 2008-09. The loans to self-help groups (SGH) have increased from 310 crores in 2001-02 to 2388 crores in 2008-09. The loans to other priority sectors have increased from 8102 crores in 2001-02 to 3662 crores in 2008-09.

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7. Loans to Agriculture and Allied Activities

Agriculture is the mainstay of Indian economy. RRBs provides short-term (crop loans) and term loans (Agricultural and Allied Activities) to farmers.

Table 12.
Disbursement of short-Term Loans (Crop Loans) and Term Loans (Agriculture and Allied Activities) by RRBs

Years	Amount of Short Term Loans (₹ in crores)	% of Increase over previous year	Amount of Term Loans (₹ in crores)	% of Increase over previous year
2001-02	3095	---	871	---
2002-03	4834	56.19	1045	19.98
2003-04	6133	26.87	1042	26.87
2004-05	9883	61.14	2043	61.14
2005-06	12575	27.23	2144	27.23
2006-07	17031	35.43	3198	35.43
2007-08	20377	19.64	3461	19.64
2008-09	22851	12.14	3648	12.14

Table 12 exhibits that short term loans for crop has been increasing year after year. Short-term loans have increased from ₹ 3095 crores in 2001-02 to ₹ 22851 crores in 2008-09. The disbursement of term loan for agriculture and allied activities by the RRBs is also encouraging. It has increased from ₹ 871 crores in 2001-02 to ₹ 3648 crores in 2008-09. The increase over the period was 4.18 times. In order to test whether the disbursement of short-term loans has the linear relationship with the term loans or not, correlation was found. The result is shown in Table 13.

Table 13. Correlation of short-Term Loans (Crop Loans) and Term Loans (Agriculture and Allied Activities) by RRBs

Column	Column 1	Column 2
Column 1	1	
Column 2	0.98909	1

The disbursement of short-term loans and term-loans of the RRBs has a strong positive correlation. The linear correlation co-efficient is 0.98909 which is close to +1. This means that the demand for short-term loan increases the demand for the term-loan.

8. Disbursement of loans to Agricultural Sector and Non-Agricultural Sector

The year wise percentage of loans disbursed to agriculture and non agriculture is furnished in Table 14.

Table 14. Loans disbursed to Agricultural and Non-Agricultural Sectors (in %)

Years	Agriculture	Non-Agriculture
2001-02	45	55
2002-03	46	54
2003-04	45	55
2004-05	51	49
2005-06	54	46
2006-07	57	43
2007-08	56	44
2008-09	64	36

H_0 - There is no change in the loan disbursed to agriculture sector after amalgamation
H_1 - There is change in the loan disbursed to agriculture sector after amalgamation

Mean	52.25	47.75
Standard Deviation	6.359088	6.359088

Table 14 reflects that loans to Agricultural Sector have increased after amalgamation. It is clearly observed that preference has been given to priority sectors. This indicates that RRBs have fulfilled the purpose of their existence.

9. Gross NPA and Net NPA

Table 15
Gross NPA and Net NPA

Year	Gross NPA	Net NPA
2001-02	16.4	11.53
2002-03	14.44	9.51
2003-04	12.63	8.54
2004-05	8.53	4.84
2005-06	7.28	3.92
2006-07	6.55	3.46
2007-08	6.04	3.36
2008-09	4.14	1.76

Table 15 reveals that gross NPA of RRBs have reduced from 16.4% in 2001-02 to 8.53% in 2004-05. But after amalgamation the Gross NPA's have further reduced from 7.28% to 4.14%. This shows that amalgamation has been beneficial for RRBs in reducing their gross NPA. Also Net NPA of RRBs has reduced from 11.53% in 2001-02 to 4.84% in 2004-05. But after amalgamation the Net NPA's have further reduced from 3.92% to 1.76%. This shows that amalgamation has been beneficial for RRBs to reduce their Net NPA. The successful RRBs continue to serve predominantly low income clients and it is the better management policies incorporating a reasonable focus on lending and diversified portfolios with good repayment performance that enables them to perform better. The successful RRBs essentially outperform their peers on account of their superior operational strategies enabled by better leadership.

10. Changes in Composition of Net Worth of RRBs

Table 16. Composition of Net Worth (in %)

Year	Accumulated Loss	Net Worth
2001-02	66	34
2002-03	59	41
2003-04	50	50
2004-05	44	56
2005-06	40	60
2006-07	38	62
2007-08	30	70
2008-09	21	79

Table 16 reveals that accumulated loss of RRBs have reduced from 66% in 2001-02 to 44% in 2004-05. But after amalgamation the losses have further reduced from 44% to 21%. This shows that amalgamation has been beneficial for RRBs to reduce their accumulated losses. At the same time, Net worth of RRBs has increased from 34% in 2001-02 to 56% in 2004-05. But after amalgamation, the Net worth has further increased from 56% to 79%. This shows that amalgamation has been beneficial for RRBs in increasing the Net worth of RRBs.

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