Chapter 1
INTRODUCTION

Rural development is both the means and end of economic development of a country like India. Today, rural development has become a matter of interest to industrialists, financiers, bankers and philanthropists, apart from the State and Central governments. In a nation like ours where the villagers constitute the majority of population, it is of paramount importance to make the life of the majority worth living and thus paying back to them also the dividend of India’s economic growth. Four decades of regulations and two decades of liberalization have made India the ninth largest economy in the world (World Bank, 2011) which has grown second after China, at an average rate of 8.46 per cent, for the last five years, even in the aftermath of global economic slowdown (Economic Survey, 2010-11). There are predictions that if the current high growth continues, India will overtake Japan (pre-quake) by 2030 (Economic Outlook – India, 2008 to 2010). Today India hosts 11 per cent of the world’s richest (Forbes India Magazine, 2010) and it is looking forward to the trickling down of this fortune to the rural people.

In India, 72 per cent of the population are living in rural areas and 69 per cent of the work force are depending on agriculture, which is the largest single contributor to the nations GDP (RBI, 2006). Traditional farming technique, poor basic infrastructure, and inadequacy of support services to agriculture make farmers and agricultural laborers backward, unemployed and poor. Despite the growth in GDP in recent years, the figures on education, health, housing, sanitation, and access to resources, from the vast country sides of India show that the trickledown effect of economic growth is rather weak (India Development Report, 2008). Even today India is widely considered as one of the hot spots for the widespread poverty and malnutrition. It is estimated that India shelters about one third of the World’s poor (World Bank, 2009) and also around 42 per cent of the rural poor in India subsist in poverty
and remains in acute shortage of basic facilities (Tendulkar Committee, 2009). Therefore, it is high time to relate economic growth with rural development.

Rural development as a concept suggests the overall development of the areas and sustaining improvement in the quality of life of rural people. It results in creating an environment conducive to improve people’s capacity and to utilize it fully, without exploitation, in a sustainable way. The Asian Centre for Development Administration defines it as a process which leads to a continuous rise in the capacity of rural people to control their environment accompanied by a wider distribution of benefits resulting from such a control. It aims to increase the real per capita income of rural people, improvement in the distribution of income, political and economic freedom and equitable access to resources, education, health care, employment opportunities and justice (Katar Singh, 2007).

In India, there have been many policy initiatives and long standing programmes to this end, since independence. Self Employment Programmes, Wage Employment Programmes, Area Specific Programmes (Programmes for the Development of Backward Areas), Integrated Rural Energy Programmes, Development of Dry Land Farming, Soil and Water Conservation Programmes and Constitution of Rural Infrastructure Development Fund are some of the programmes implemented from time to time. Though the multiplicity of the programmes created a problem of coordination and poor loan recovery (Neeta Tapan, 2007), these programmes have jointly increased the rural productive capacity by adding the physical assets like roads, minor irrigation net works and other social assets (Thingalaya, 2011), and thereby the percentage of people below poverty line came down from 56.44 per cent in 1973-74 to 28.30 per cent in 2004-05 (Planning Commission, 2009). Learning from the experience, today rural development programmes have been redesigned to confine the government’s role to the provision of good technology, management skills and cheap credit and other financial products in the villages.
1.1 Rural Development and Rural Banking

India has 6.4 lakh villages with a population of 83.3 crore which constitute 68.84 per cent of the whole India (Census India, 2011). Providing timely and adequate cheap credit to farmers, rural artisans, petty shop keepers, and micro and small entrepreneurs is of paramount importance. It is reported that rural India suffers from a more serious lack of finance than urban Indian (Bose, 2004, Shah et al., 2007., Mishra. and 2008., Remesha, 2003). Keeping of around 80 million out of the banking services net, will come in the way of development, as they account for the majority of consumer spending in India; more than $ 100 billion a year (Musthafa, 2010). The real source of market promise is not the wealthy few or the emerging middle income group, it is but the billions of aspiring poor who are joining the market economy for the first time (Prahalad, C.K, 2006).

1.2 Government Initiatives towards Rural Banking Extension

In order to spread the banking services to rural areas and to promote financial inclusion, Government of India under the guidance of RBI, has taken various policy and as well as administrative measures. Though it dates back to 1904, when the first Co-operative Societies Act was passed to give co-operatives a separate legal identity, it was with the inception of Reserve Bank of India (RBI) in 1935, that the financial inclusion efforts received proper direction. Setting up of State Bank of India (SBI) in 1955 for economic regeneration of rural areas, nationalization of 14 major commercial banks, identification of priority sector in the economy and the introduction of Lead Bank Scheme (LBS), all in 1969 and the branch licensing policy of RBI adopted in 1970, were the other attempts to ensure targeted credit flow to the rural areas.

Setting up of regional Rural Banks in 1975, combining the feature of co-operatives and commercial banks, setting up of National Bank for Agriculture and Rural Development (NABARD), introduction of Service Area Approach (SAA) in 1988, linking of Self Help Group (SHGs) with banks in 1992,
introduction of Kisan Credit Card (KCC) in 1998, facilitating of No Frills Account (NFA) in 2005, introduction of the idea “banking correspondents and business facilitators” in 2006 were also some of the major policy initiatives of the GoI., towards this end.

As a combined effect of the above measures, the rural financial infrastructure has improved a lot. Today formal credit agencies with multiple windows and credit products serving different socio-economic and agro-climatic zones have assumed a prominent position in the rural and agricultural sector (Nanda, 2002). The policy towards rural credit was to ensure the provision of sufficient and timely credit at reasonable rate of interest to the largest possible segment of the rural population (Thorat, 2006).

In 1975, Regional Rural Banks (RRBs) were set up with an intention of providing formal banking services to rural folk, so as to save them from usury. By 1990 their number increased to 196, covering 512 districts in the country. Kerala was the state that had India’s largest RRB till 2005-06. Now for RRBs, after an amazing phase of expansion, restructuring and turn around, a period of consolidation has emerged. Therefore, it is a better time to evaluate their performance and seek the possibilities to regain the lost growth momentum of RRBs.

1.3 Review of Literature

Ever since their inception in 1975, RRBs have attracted the attention, applause and criticism of all its stake holders across the country. During these periods many systematic studies about RRBs have been done by individuals, institutions and governments. There are studies relating to the RRBs in general, RRBs in a particular region, RRBs under a particular sponsor bank or about a particular RRB. Research studies and Committee reports having relevance in the present study area viz., operational and financial performance, and development role played by a particular RRB, even though scanty, are reviewed here. Reviews are arranged in a chronological order.
Alamelu, K and Devamohan, A (2010) examined the turnaround scenario of RRBs and observed that the process of its revitalization was a fruitful exercise. However, there are some weak areas such as low financial return, thin margin and poor employee productivity which need further improvement. They also made the following suggestions.

1. Since the business of RRBs need an immediate push, offering other financial services like savings and insurance products must also be considered.

2. The relation with sponsor bank branches in the same locality must be changed to a synergistic one in place of competitive.

3. RRBs should also be subject to same level of safeguards and regulatory norms regarding capital adequacy as applicable to commercial banks.

4. RRBs may be allowed to deal in Non-Resident External (NRE) accounts/Foreign Currency Non-Resident (FCNR-B) deposits, certificates of deposits etc.

5. Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act (SARFAESI), 2002 may be extended to RRBs.

Kshirsagar and Deepak Shah (2009) conducted a study to examine the borrowers experience with rural lending institutions in Kolhapur and Pune districts of Maharashtra. They found that new generation lending institutions like SHGs showed charging high rate of interest on loans and advances, while the traditional institutions such as commercial and co-operative banks are beset with other deficiencies such as high transaction cost, delay in credit delivery and absence of human capital investment and consumption loans, especially for illness, marriage and other contingencies. They suggested to make loaning procedure simple and to make use of KCC group lending through SHGs to extent the credit to rural mass.
Nageshwar Rao and Shefali Tiwari (2009) in their study examined the efficiency indicators of commercial banks. They suggested that branch wise profits and business could be increased by shutting down the non-viable branches. The rural branches must be restructured so as to extend their activities beyond the provision of credit. They must advise people on how to utilize the money more productively. Public sector banks must reduce the operating expenses to increase the per branch profitability.

Prabhakaran Nair, V.R (2009) in his article examined the procedure and problems of preparing the credit plans for the districts. He opined that lack of integration of Service Area Credit Plans with the local development plans, inadequate data base of for credit planning, lack of integrity from the part of individual banks in making an independent assessment of the local credit needs etc. rendered the district credit plan ineffective.

Rajeev Khosla and Ramanjeet Singh (2009) suggested that RRBs should serve low income group better on a priority basis as they are originally meant for it. The study also suggests that instead of developing the entire district a small area must be developed first to create employment.

ASSOCHAM (2009) conducted a joint study with the Ernest and Young, a research firm, to evaluate the state of rural finance, and they show that the banking services in the rural and semi urban areas have mainly been extended by the RRBs and co-operatives banks but they lack competitiveness for want of financial and operational viability. The study suggests that the Govt. and other regulators must come forward with proper directives to consolidate the RRBs and rural credit co-operatives bank to increase their competitiveness.

Mohinder Kumar (2008) in his study entitled “Rural credit issues, Contradictions and Perspectives” observes that the present rural credit system consisting of SCBs, RRBs, Co-operative banks and SHGs and the state intervention are not suited to small farmers. A reorganization of production
relations based on associated (group farming) production by farmers and their joining with corporate capital has to be thought of. The co-operative banks must be retained to deposit the money which farmers earn while RRBs must be merged. The credit gap has to be filled by the corporate capital. In associated joint capitalist farming the farmers are not wage earners but equal partners.

Bhagaban Padhy (2008) made a study on the role of RRBs in agricultural development and this study reveals that the institutional finance is inadequate in the rural areas and money lenders still dominate in the market. Commercial banks shutdown their rural branches and they give more importance to profit rather than to service. So he argues that RRBs are to be strengthened as they are the best fit to serve the rural.

Jogasankar Mahaprasastha (2008) observes that even though large farmers have access to formal credit, they depend lightly on it. It is also observed that the average amount of formal loan is higher than that of informal loan in developed areas compared to undeveloped areas. The study also suggests that the effective cost of formal loan has to be reduced.

Sharma, R.K., Sonika Guptha and Bala (2008) in their study found that credit was very low among farmers due to small holding and resultant low collateral. Borrowing for needs like machinery, farm equipment etc. was usually avoided. The institutional loan was found more important. Among non institutional sources, money lender had no role but the friends and relatives were found to be significant. According to their study, the commission agents and wholesalers are playing an important role.

Vasam Anand Kumar (2008) in his study, after analyzing the variables such as age of banks, branch expansion, CD ratio, recovery position, profit and loss position, non performing assets and other key indicators of financial performance, has made a case against amalgamation of RRBs. He points out that based on a systematic analysis of the above variable there is no need for
amalgamating the RRBs. He also gives a warning that by amalgamating the banks some of the rural branches are likely to be closed or shifted to towns and that will throw the rural poor to the merciless money lenders and there by the amalgamation will become the death knell of the rural poor.

Manas Chakrabarthy (2008) made a study on the performance of RRBs in West Bengal. He found that the profitability and viability of relatively old RRBs was very pathetic compared to RRBs established after 1977. The study also found that the viability factor was completely overlooked for a long time until the introduction of banking reforms in 1991. The study further observes that since the inception of RRBs the policy makers have utilized them for the uplift of the rural poor through the advancement of credit and therefore it is meaningless to expect these institutions to perform at par with the other commercial banks in the matter of profitability.

Lakshmi Narasaiah, M and Ramudu, R (2008) in their study has found that RRBs lack a sound fixed deposit base, which is essential to advance medium and long term loans to rural people to invest in income generating activities. RRBs have played an admirable role in extending credit to rural poor and in the balanced regional development. In the matter of local feel and low cost, the banks have succeeded.

Kanak Kanti Bagchi and Abdul Hadi (2006) in their study found that the policy initiatives introduced by GoI., RBI and NABARD helped RRBs in West Bengal to turnaround. He also suggests that to strengthen the earning capacity of RRBs further policy measures such as appropriate legal support, strengthening of the personnel policies, allowing greater freedom relating to certain aspects of loaning process etc., are needed.

Biswa Swarup Misra (2006) in his attempt to evaluate the performance of RRBs in India concludes that while the investment portfolio contributes positively, the loan portfolio is still a matter of concern for the profit making
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RRBs. While sponsoring banks of profit making RRBs contribute creatively, those of the loss making ones act as a drag on their performance. Such sponsoring banks should be asked to improve their contribution within a stipulated time, failing that a change of sponsor bank may be considered.

Loganathan, P (2006) in his study of RRB finance to SHGs in India found that there were disparities in SHG financing by these banks in different regions. It also reveals that though the RRBs are concentrated in the central region of the country, their performance in this regard are quite low compared to other regions.

Rabi N. Misra and Rajagopal Rao, G (2006) in their study analyses the reasons for overdue in RRBs in Orissa. They observe that literacy, age, and length of processing period have a direct relation with the chance for default in Orissa.

Anurag Agarwal (2005) made an evaluative study to find the problems and prospects of RRBs in India in general and he points out) that the pro poor image of the bank desists a section of the society from banking with RRBs, and the confinement of its staff to the local aspects has narrowed down the vision and experience of the staff. He also cautions that if tangible reforms are not introduced in the RRBs to make them competitive, they may fail to achieve the destined success.

Subbiah, A and Selvakumar, M (2005) made a study to find the role of RRBs in the financing of agriculture. They have found that commercial banks are closing down their rural branches and the chance of rural poor for institutional credit is eroding. So the Govt. has to strengthen the RRBs to save the poor from the money lenders.

Sundar, I (2005) conducted a study to examine the extent to which the RRBs have financed the women self help groups in different parts of the country. He found that there was wide variation in the implementation of
women development programmes across the country and he also suggested certain policy changes to rectify the problems.

Abhimandas and Saibal Ghosh (2005) in their study has found that there are symptoms of excess capacity in regional rural banks in India as reflected in low loans to asset ratio, low profitability and high per unit total expenses.

Gangadharan, T.G (2004) in his study examines the reasons for the mounting over dues with the RRBs. He identifies a combination of factors responsible for it. Lack of rescheduling facility, inadequacy of loans, improper timing of disbursement, short repayment period, absence of moratorium, foreclosure of loans, faulty classification of small farmers thereby denying them longer repayment period, poor income generation, willful default, political interference etc. are the reasons pointed out by him.

Vimala, P (2003) conducted a study to evaluate the performance of RRBs in Kerala based on secondary data relating to the allocation and achievement of targets in the district credit plan. The study reveals that both South Malabar Gramin Bank and North Malabar Gramin Bank have achieved targets priority sector in general and its sub sectors in particular in all the years.

Naqi Uddin (2003) in his study points out the main organizational, managerial and administrative problems faced by RRBs in India. Defective control and monitoring, poor staffing, poor resources and fund management, low CD ratio, defective appraisal of borrowers low recovery, lack of banking habit among rural people problems inherent with agriculture are the problems identified in the study.

Thingalaya, N.K (2001) in his study reveals some operational and institutional impediments such as bulging nonperforming assets, lack of profit planning, lack of autonomy, and indifference of state governments. He suggests that the profit making RRBs should be separated from the system and let to stand alone; the weaker ones making losses must be privatized, instead of
additional capital infusion by the Governments, with a fiscal benefit tag to the private participants. The chronically weak RRBs must be left to be taken over by highly profitable new breed banks who are always seeking mergers and acquisitions.

Bhatt and Thorat (2001) made a study to evaluate the institutional dimensions of reform process initiated in the RRBs in India. They found that in addition to the unsuitable increase in the lending interest rates that lead to the decline in the loan growth, inappropriate implementation of the policy programmes, inadequate infrastructure, staff motivation at the field level, also lead to the poor financial performance of the RRBs. They also opined that efforts to reform the RRBs had only a limited impact because reforms had paid little attention to redesign the incentive plans for different stake holders, especially the banks work force, in such a way that the programme outreach and sustainability become the best interest on both the clients and officials.

Chauhan (1991) in a study found that the demand for loans exceeded the supply in the rural areas as most of the banks were reluctant to lend to the rural poor. Due to urgent consumption needs, about 35 per cent of total loans were put to unproductive use. It was also revealed that only very little surplus income existed within the sample households, ranging from 7 per cent to 16 per cent on an average.

Velayudhan and Sankaranarayanan (1990) made a detailed study about the problems of mounting losses and overdue, financial viability, management aspects, industrial relations etc. The study concluded that in spite of the various spiraling problems, RRBs had a very important role to play in the rural development both as a principal entity in the multi agency rural credit system and as an agency to distribute income in the rural areas.

Balishter (1990) studied the influence of RRBs on the standard of living of the beneficiaries and found that there had been perceptible increase in the
income and employment of the borrowers due to the activities of the bank and that there had been a shift in cropping pattern from low income crops to high income crops.

Krishnan and Balakrishnan (1989) found that disbursement of loan to agricultural allied activities in general and to dairy in particular by RRBs had been steadily increased over the years. They further opined that the volume of credit to dairy sector had to be increased and the bank should try to provide marketing facilities to the dairy sector by linking with co-operative agencies.

Dhabal and Battacharya (1989) studied the overdue and recovery problems of RRBs. Similar studies have been there by Khuchadithya and Shiyani (1988) all studies invariably cautioned about the ever increasing overdue. The study suggested various measures like improving the repayment mentality of customers and legal proceedings against purpose full defaulters to check overdue.

Shete and Karkal (1989) made a comprehensive study to validate the functioning of RRBs. They reported that RRBs had not neglected the backward states and regions and they served the rural farmers, artisans and small traders better.

Moin Quazi (1989) in their study found that RRBs fully supported the government in the employment generation efforts. They were also described as the champions of Integrated Rural Development Programme.

Rao (1988) In his article that inquires into the problems of RRBs observed that the multiplicity of controlling agencies like RBI, GoI., NABARD, and the sponsoring bank, stand in the way of timely decisions. The study recommended the amalgamation of all RRBs in to National Rural Bank under a single agency NABARD.
Krishnan (1988) found a notable increase in the advances of agricultural and non-agricultural credit by RRBs. The structure of agricultural credit showed a bias towards short-term credit. The study also noted gross misuse of agricultural gold loan. The study concluded with some suggestions like introduction of end-utilization visit in agricultural gold loan cases, linking of repayment with income generation, increase in the amount of loan for purchasing milk animals etc.

Hossain (1988) conducted another study to assess the effect on income of Grameen bank members. A detailed household survey in five project villages and two control villages revealed that the income of bank members was 43 per cent more than that of non members. This increase in income was attributed to the various projects like manufacturing and processing, transport and trading etc. undertaken by the bank members with financial support from the bank. Thus the study concluded that the bank had made remarkable contribution to reduce the poverty in the area of its operation.

Devendra Babu (1988) in his study to find the adherence of RRBs to their mandate of being the rural financial intermediary found that RRBs seldom from their mission of serving the rural farmers, small traders artisans and other rural mass.

Ramakrishnan (1988) in his study found that the banks were not getting financial support from the state governments as visualized by the working group on RRBs and the study also suggested that the control of the RRBs had to be vested in the sponsoring bank alone.

Shahana Ghosh (1988) in his article found that the RRBs succeeded in meeting their founding objective of taking banking to the grass root level. For making the banks more resourceful he suggested to merge the RRBs in the same district. He opined that it is unfair to judge the RRBs on the basis of their
trading result as their main aim was not to maximize profit but to maximize rural outreach.

Nagi Reddy and Rathna Kumari (1986) in their study to learn the reasons for poor financial performance of RRBs, found that low yield, low market price for the produce, repayment of other debts and their domestic consumption were the main reasons for non-repayment of loan. It also found that if there are better yields and persuasion by bank officials there will be prompt repayment.

Balishter (1986) have undertaken a study to evaluate the performance of the Jamuna Gramin Bank. The study found that the bank is serving the rural people better than the other scheduled commercial banks and it was concluded that, in future greater priority should be given to expansion of rural banking by strengthening the RRBs.

James (1986) conducted a study about the rural development activities of North Malabar Gramin Bank. The study found that, 62 per cent of the borrowers did make proper use of loan. About the repayment performance of the loanees the study found that majority of the defaulters belonged to the dairy scheme followed by self-employment and business schemes. However, since he followed a defective sampling procedure the study is not a dependable one.

Ravindran (1986) conducted a study about the recovery problems related with the agricultural loan of North Malabar Gramin Bank. Even though the recovery pattern was poor, the study found a many fold increase in the quantum of financial assistance for agricultural and allied activities and that the bank finance had reduced the dependence on money lenders of target borrowers, especially Scheduled caste and Scheduled Tribes, in whose matters the bank had taken keen interest.

Lakshmi Narayana (1984) in a study on RRBs in West Bengal found that the problem of over dues had an adverse impact not only on their financial
performance. The recovery work of overdue loans together with the normal work of processing new credit proposals and enlisting new borrowers hardly allowed the bank officials any time for guiding the loanees in adopting improved farming techniques and making better use of credit.

Singh and Upadhya (1984) conducted a study on the loan recovery aspect of RRBs in Bihar. They observed that the lack of serious attitude of borrowers towards repayment, crop failure, expenditure on marriage and other social functions in the family and inadequate follow-up measures were the important factors that led to the non-repayment of loan.

Kamath (1984) in a study found that with regard to branch expansion, deposit mobilization and credit deployment, the RRBs in general have succeeded. The study also found that the working of the two RRBs in Kerala was better than most of the other RRBs. The study concluded that, though there was a strong co-operative sector in Kerala, there was also a good case for extending the benefits of RRBs at least to the relatively backward districts of the State.

CRAFICARD (1981) Committee to Review Arrangements for Institutional Credit for Agriculture and Rural Development studied the financial viability of RRBs. By that time some of the RRBs had made alarming loss. The committee found that RRBs were more suitable to cater to the needs of rural people and recommended that preference should be given for RRBs in the matter of branch licensing in the rural areas. It also recommended that they should continue their endeavor to serve the rural people. The loss incurred so far should be made good by the share holders in the same proportion of their capital contribution.

Reddy and Suresh Kumar (1982) in their studies came to the conclusion that, weaker sections like small and marginal farmers and agricultural labourers had got the major share of credit from the bank.
Wadhva, C.D (1980) conducted a case study of two RRBs working in Haryana and Rajasthan in 1977. It found that RRBs inherited complicated procedural formalities from their sponsor banks and also the RRBs were not able to meet the targeted disbursement of credit set by the Government of India. The study attributed the poor performance of RRBs to the limited scope for direct lending by RRBs in the areas of operation, absence of effective links with primary co-operative societies and farmers service societies and lack of adequate support from government for expanding business. The main limitation of the study was that it came immediately after the setting up of RRBs.

Saudamini Nagar (1979) conducted a study of the functioning of RRBs in Rajasthan and found that these banks had made creditable progress in deposit mobilization and credit distribution.

Haslem (1968) in his study that inquires into the factors that affect the performance of banks recognizes two sets of factors; external factors and internal factors. External factors are systemic forces that reflect the economic environment which conditions the operations and performance of financial institutions. The internal factors originate from the balance sheet and profit and loss account of the bank concerned and are often termed as the micro/bank specific factors.

1.3.1 Studies of Committees and Working Groups on RRBs

Narasimham Committee (1975) recommended the formation of RRBs as scheduled commercial bank with equity participation of Central Govt. (50%) State Govt. (15%), a commercial bank (25%) and institutions or individuals of local domicile (10%). The committee also detailed the administrative and operational aspects; with small variations, the report implemented in the same year itself.
Dantwala Committee (1978) reviewed the working of RRBs in the light of the qualitative and quantitative credit gap existed in the rural sector. The committee rendered detailed report commenting about the area of operation, role of neighboring scheduled commercial banks, the percentage of advances to be earmarked to small farmers and artisans, role of RBI in the operational supervision and a different capital structure incorporating RBI as a share holder in place of the Central government.

Sivaraman Committee (1981) endorsed the recommendations of the Dantwala committee to entrust RBI with the responsibilities of GoI., relating to the promotional and developmental activities of RRBs. The committee also recommended making good the losses of RRBs by the stakeholders in the proportion of their capital contribution. Further to transfer the eligible business of rural branches of commercial banks to RRBs in the area and to follow a flexible approach to the area of jurisdiction of RRBs in peculiar regions likes the north-east part of India.

Khelkar Committee (1984) studied the problems of RRBs and recommended to merge the small and uneconomic one for economic viability and the accumulated losses to be compensated by way of grants from the stakeholders in the ratio of their equity holding. Further it opined that, to fulfill the SLR requirements, they should be allowed to invest in Government securities with the support of the sponsor banks.

Khusro Committee (1989) report had many crucial recommendations. The Committee took note of the serious problems of RRBs on account of continuous decline in the profits, poor recoveries and problems relating to management and staff. The committee noted that the handling of small loans causes high operating costs, which erodes profitability. The Committee identified willful defaults, misuse of loans, staff agitation, granting of benami loans etc, as the reasons for poor recovery. They observed that the situation that existed at the time of formation of RRBs does not exist at the time of report.
So, after considering many alternatives, recommended to merge the RRBs with their sponsoring banks.

Narasimham Committee (1991) after examining the viability issue recommended that, to impart viability, RRBs should be allowed to engage in all kind of banking business without restricting to a particular target group. The surplus of RRBs should be placed with NABARD or some such agency, which will invest in most profitable avenues to increase the revenue of RRBs. The Committee also observed that, the solution lies in evolving a rural banking structure which would combine the local character of the RRBs with the financial, managerial and organizational strength of commercial banks. For this each commercial bank can start a rural subsidiary by taking over their rural branches.

Bhandari Committee (1994) in its report identified 49 RRBs for restructuring. The committee also made recommendations relating the return from investments, skill up gradation of employees, devolution of decision making powers to the Boards of RRBs and appointment of Chairman/CEO for RRBs.

Misra Committee (1995) made several recommendations relating to the kind of securities to be invested, term of deposit of RRBs, Tax exemption of interest on investment of rural savings of RRBs etc.

Basu Committee (1996) was appointed to examine avenues for strengthening RRBs. The committee identified 68 RRBs to restructure as a second phase of intervention. The other recommendations of the committee were (a) introduce prudential norms for RRBs with necessary modifications, (b) to subsidize the premium to be paid to Deposit Insurance and Credit Guarantee Corporation (DICGCI) on loans below Rs.25000, or to pass these costs to the customers, (c) liquidate those RRBs which cannot stand alone or revamp, and (d) define the role of stakeholders more clearly.
Thingalaya Committee (1997) recommended the categorization of the RRBs as per their viability status and based on which decision making authority could be delegated to them. The committee also recommended letting the RRBs to open branches in high business centers. Other important include recommendations strengthening of internal inspection system, setting up of vigilance cell, liquidation of very weak RRBs etc.

Narasimham Committee II (1998) stands as the forerunner of banking and financial sector reforms in India. In addition to prescribing certain measures for the entire banking institutions for identifying the eligible customers for government schemes, the committee made some RRB specific recommendations. They are: (a) RRBs should reach a capital adequacy ratio of 8% within the following 5 Years (b) all regulatory and supervisory functions over rural credit should be lifted from NABARD and be placed on a new institution created for the purpose (c) to meet the banking needs of the rural poor, banking policy should facilitate the evolution and growth of micro finance and Local Area Banks as may be promoted by non-governmental agencies (d) RRBs should not forget to maintain efficiency, solvency, productivity and profitability while discharging the duties as a rural banker.

Agrawal Committee (2000) fixed the staff norms for RRBs on a unit basis relating the CD ratio and NPA position. It recommended opening one area office for every 25 branches. Manpower shortage is to be managed by deputing from the nearby RRBs with surplus. Introduction of multipurpose workers in place of clerical cadre, computerization of head office, area office and 50 per cent of branches were the other recommendations.

Vyas Committee, I (2001) recommendations were pointers to the privatization of RRBs. The committee recommended letting willing parties to purchase the share of defaulting state government at a price determined by a professional. Further, those RRBs which do not have any accumulated loss
may be permitted to register as Local Area Banks under Companies Act, and may be allowed to acquire capital by initial public offering (IPO).

Vyas Committee, II (2004) opined that the mandate of RRBs as the bank for the poor had to be continued even when they are restructured. The committee put forward a two-step amalgamation strategy. Firstly all RRBs of a sponsor bank in a state would be amalgamated into a single unit. Under the second phase, state level rural banks will be formed by amalgamating all RRBs regardless of amalgamated or not. Further, RRBs Act 1976 may be replaced by a new one.

Chalapathy Rao Committee (2001) recommended introduction of capital adequacy norms in a phased manner to RRBs with modifications. Further, it suggested to categorize the RRBs on the basis of four financial health parameters and also to liquidate the least healthy RRBs to secure the depositors.

Sardesai Committee (2005) was appointed by RBI to examine the fate of the recommendations of the earlier committees and to undertake a state wise, sponsor bank wise evaluation of the performance of RRBs in India. It opined that RRBs were facing many constrain warranting an overhaul for strengthening them. The Committee recommended many options such as merger/amalgamation, change of sponsor banks, balance sheet strengthening, maintaining minimum capital adequacy etc.

From the foregoing reviews it can be observed that, most of the studies are on general problems of RRBs, done on all India basis or with special emphasis to the northern States. Further, most of the studies deal with insider’s problem or perspective like, low recovery, low profitability or mounting NPA etc. Bank specific studies, enquiring the contributions made in to the development of agriculture, industry and services, the major rural development pullers, are definitely scanty. Again, most of the researches were undertaken on
the basis of secondary data. Hence, there is genuine need for a methodological study using primary data to appraise the contribution of one of India’s erstwhile largest RRB. It is in this backdrop that the present study has been carried out.

1.4 Statement of the Problem

Regional Rural Banks have been functioning in India since 1975. Though, the idea of ‘blending the local feel and familiarity with large resource base’ received good appreciation in rural India, but before long, the RRBs developed financial viability problems. Based on various studies GoI, undertook remedial measures that brought down the number of RRBs in India from 196 in 1991 to 82 in 2010 and number of loss making RRBs from 90 in 2004 to 29 in 2010. Thus, barring a few, most have “turned around” but are often characterized as ‘investment’ rather than credit institutions and these are perceived to have deviated from the mandate of serving the poor and disadvantaged (Thorat, Y.S.P, 2010). The then started transformation and consolidation process is still on.

South Malabar Gramin Bank, one of the two RRBs in Kerala, was established in the year 1976 with head quarters at Malappuram. Although it operates in eight districts of the State, almost 80 per cent of the branches of the bank are located in the four districts, viz., Malappuram, Kozhikode, Waynad, and Palakkad. It was the biggest RRB in India, in terms of total business between the year 2003 and 2006, and it is one of the biggest bank net works in the four districts. Further, SMGB is one of the few RRBs that did not need any financial reorganization. Even though the average CD ratio of other scheduled commercial banks operating in the area is between 60 and 65 per cent (Economic Review, various issues, government of Kerala), the CD ratio of this bank is, on an average of 100 per cent (Annual Report of SMGB, various issues). Though the SMGB has grown manifold in terms of total business, customer base and number of branches, it is observed that since the year 2002 the growth in number of branches and also in the number of employees in these districts has been remaining stagnant. Despite good banking penetration,
literacy among customers, money lenders of both local and neighboring states are actively playing in the region. Now it seems that SMGB is now focusing on extending its service to other districts of South Kerala and its expansion programme in northern districts is seemingly complete.

Thus, it is the time to make an empirical study of the role already and being played by the South Malabhar Gramin Bank in the rural development of four districts of northern Kerala.

1.5 Significance of the Study

Regional rural banks were established as a strong mechanism to match the credit needs of rural people, which exceeded the capabilities of the co-operatives, following a surge in the farm sector due to the plan support extended to the sector, by the central government. Even though the prominence of agriculture in the GDP has decreased over the years, the relevance in terms of rural occupation has only increased.

Kerala, while a State with notable repute in the social advancement, its northern districts are comparatively less developed and rural. Except Kozhikode, other districts such as Malappuram, Waynad and Palakkad are the least GSDP per capita districts in the State (Economic Review, 2009). With regard to public sector employment, number of registered factories, and number of other enterprises, the regions lag behind southern region of Kerala. Tertiary sector earns most of the income and dependence on NRE income is also prominent. Though Waynad district stands first in agricultural income in the region, it has a high incidence of farmer suicides reported intermittently in recent years. South Malabhar Gramin Bank, one of the RRBs in Kerala has been functioning in these areas since more than three decades. It is one of the biggest bank net works in the area and this is the major area of the bank. It has 181 branches in the study region which is more than 80 per cent of its total branches. The bank has been in the forefront of the financial inclusion campaign in the region.
This study is an assessment of the development role of the bank in the agriculture, industry and service sectors of the region from the customers’ perspective. The result of the study will provide certain ground level information with regard to the development role played by the SMGB, its reach and effectiveness in the society, and further, the expectations of the customers and officials of the bank. Besides this, the study will also reveal the operational and financial state, the bank has reached all through the years. All these will help to provide direction to the development efforts of rural development institutions, policy makers and planners in general and, the government of Kerala, farmers, MSMEs, customers and officials of SMGB in particular.

1.6 Scope of the Study

The present study intends to assess the development role performed by the South Malabar Gramin Bank, in the agriculture, industry and service sectors in the four northern districts of Kerala, viz., Malappuram, Palakkad, Kozhikode and Waynad as 80 per cent of the bank branches are spread in these districts. Apart from an evaluation of the financial and operational performance, the different loan schemes, their disbursement, utilization, after effects and other advisory and management services of the bank are assessed by taking the direct opinion of bank’s customers having a relationship of more than three years. The opinion of officials of the concerned branches, selected area offices and the Head office have also been taken into consideration in order to substantiate, and sometimes, to cross check the details collected. As the volume of business from other activities of the bank is significantly low the study has not peeped in to such sectors.

1.7 Objectives of the Study

The study focuses on the following objectives.

1. To study the measures adopted by SMGB for the promotion of agriculture, industry and service sectors of northern Kerala.

2. To assess the effect of the promotional measures on the socio-economic status of beneficiaries of SMGB in northern Kerala.
3. To examine the operational and financial performance of SMGB.

1.8 Hypotheses

In line with the objectives, the following hypotheses are set for the study.

1. Not more than one half of the customers of SMGB are aware of the loan schemes.
2. Not more than one half of the customers of SMGB get the entire project cost.
3. Not more than one half of the customers of SMGB face hardships while availing the services.
4. Not more than one half of the customers have increased their level of employment after availing credit.
5. Not more than one half of the customers have increased their level of income after availing credit.
6. Not more than one half of the customers have increased their level of savings after availing.
7. SMGB has contributed to the socio-economic progress of not more than one half of the customers.

1.9 Methodology

The present study is empirical in nature. All offices of SMGB in the four districts of Kerala viz., Palakkad, Kozhikode, Malappuram and Waynad constitute the universe of the study. There were 185 offices including area offices and head office to SMBG as on 31st March 2010. Of these 40 offices in proportion to the total number of branches in each district were selected at random, viz., Malappuram 17, Kozhikode 15, Palakkad 4 and Waynad 4. The borrowers and officials of the sample offices are the respondents. There were 81639 customers in the 40 branch offices on 31st March, 2010. From this population, 400 customers selected from these four districts as Palakkad 31, Malappuram 177, Kozhikode 150 and Waynad 42 constitute the first category of respondents. While selecting the customers due representation was given to agriculture, industry and service sectors. Thus, 112 customers are from agriculture, 105 from industry and 183 from service sector were selected as per
The Role of South Malabar Gramin Bank in the Rural Development of Northern Kerala

Slovins Formulae. The officials of the 40 selected branches were the second set of respondents. Of the total 201 officials in the 40 selected offices, 100 officials (50%) have been selected as respondents. Convenient sampling technique was used for selecting the sample respondents from officials (Table 1.1).

**Table1.1: Number of Branches and Officials Selected as Samples**

<table>
<thead>
<tr>
<th>Districts</th>
<th>Offices*</th>
<th>Officials</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total</td>
<td>Sample</td>
</tr>
<tr>
<td>Palakkad</td>
<td>14</td>
<td>4</td>
</tr>
<tr>
<td>Malappuram</td>
<td>82</td>
<td>17</td>
</tr>
<tr>
<td>Kozhikode</td>
<td>69</td>
<td>15</td>
</tr>
<tr>
<td>Waynad</td>
<td>20</td>
<td>4</td>
</tr>
<tr>
<td>Total</td>
<td>185</td>
<td>40</td>
</tr>
</tbody>
</table>


Both primary and secondary data were used for the study. The primary data were collected from the sample respondents through two sets of pre-tested structured interview schedules (given as Annexure I and II). The secondary data were collected from the annual reports of SMGB, NABARD, RBI, books, periodicals, Committee Reports and the Internet.

**Table1.2: Number of Customers Selected as Samples**

<table>
<thead>
<tr>
<th>Category</th>
<th>Palakkad</th>
<th>Malappuram</th>
<th>Kozhikode</th>
<th>Waynad</th>
<th>Total Customers</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Customers</td>
<td>Customers</td>
<td>Customers</td>
<td>Customers</td>
<td>Customers</td>
</tr>
<tr>
<td>Agriculture</td>
<td>1633</td>
<td>8</td>
<td>12654</td>
<td>62</td>
<td>2857</td>
</tr>
<tr>
<td>Industry</td>
<td>1020</td>
<td>5</td>
<td>10409</td>
<td>51</td>
<td>8980</td>
</tr>
<tr>
<td>Service</td>
<td>3674</td>
<td>18</td>
<td>13062</td>
<td>64</td>
<td>18778</td>
</tr>
<tr>
<td>Total</td>
<td>6327</td>
<td>31</td>
<td>36125</td>
<td>177</td>
<td>80615</td>
</tr>
</tbody>
</table>


The data collected were classified and analyzed with the help of a computer keeping in view the objectives of the study. For the purpose of analysis, statistical tools viz., average, percentages, weighted mean, chi square, ANOVA and Z test were applied. The weighted mean was applied to determine the relative order of preference of the respondents. While the chi-square test was applied to examine the significant variation in the opinion among respondents in the four districts of Kerala. The ANOVA was used to test the
significance of the difference between the variance of responses of the respondents. The Z test was used to test the hypothesis.

1.10 Period of Study

The study confines itself to a period of ten years starting from the Silver Jubilee year of SMGB i.e., financial year 2000-01 to 2009-10. This period is crucial for RRBs in India, besides this being so for the entire banking industry in the world. This period witnessed the constitution, submission and implementation of various committee reports in connection with RRBs and the historic restructuring of RRBs in India. It was during this period that the number of RRBs in India reduced from 196 in 2001 to 82 in 2010 and the number of loss making RRBs declined from 46 to 29 in (NABARD, 2011). The gradual retreat of scheduled commercial banks from and penetration of Micro Finance Institutions (MFIs) in to, rural India and also the reports of continued farm suicides in Kerala and elsewhere in India are the rural socio-economic features of the period.

1.11 Variables Used for the Study

1.11.1 Measures of SMGB for the Promotion of Agriculture, Industry and Service Sectors of Northern Kerala

1. Lending schemes for agriculture
2. Lending schemes for industry
3. Lending schemes for service
4. Amount of loans outstanding
5. Age of relationship of customers with the bank
6. Type of security
7. Processing time of loans
8. Amount of loan demanded
9. Amount of loan sanctioned
10. Adequacy of loan
11. Number of visits to the bank before sanction
12. Number of pre-sanction visits by the bank
13. Awareness of the loan schemes
14. Expenses on loan
15. Degree of loan use diversion
16. Alternative source of finance to customers
17. Assessment criteria for applicants
18. Degree of default of loans
19. Reasons for loan default
20. Difficulties in dealing with the bank
21. Nature of difficulties
22. Reasons for selecting SMGB

1.11.2 Effects of Promotional Measures on the Socio-economic Status of Beneficiaries
1. Generation of employment for self after availing the loans
2. Generation of employment for others after availing the service of SMGB
3. Increase in income after the loan
4. Increase in assets after the loan
5. Type and size of savings after the credit
6. Presence in the public domain after the loans
7. General impression of customers on the promotional role of SMGB
8. General impression of officers on the promotional role of SMGB
9. Methods to assess the post loan performance of customers

1.11.3 Operational and Financial Performance of SMGB

(A) Operational Performance
1. Branch expansion
2. Business growth
3. Customer base
4. Number of employees
5. Loan schemes
6. Documentation
7. Processing fees
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8. Security for loan
9. Margin money
10. Rate of interest
11. Amount of loan
12. Repayment mode
13. Financial inclusion initiatives
14. Recovery performance
15. Management of NPA

(B) Financial Performance

1. Profit margin
2. Net interest margin ratio
3. Interest spread or net interest income
4. Return on assets
5. Return on equity
6. Asset utilization
7. Income per employee
8. Profit per employee
9. Business per employee
10. Operating cost to assets ratio or intermediation cost ratio
11. Cost to income ratio
12. Ratio of wage bills to intermediation cost
13. Ratio of wage bills to total expenses
14. Ratio of wage bills to total income
15. Ratio of burden to total assets
16. Cost of deposits
17. Cost of borrowings
18. Cost of funds
19. Return on advances
20. Return on investments
21. Cash-deposit ratio
22. Credit-deposit ratio (CD ratio)
23. Investment-deposit ratio
24. Ratio of demand and savings bank deposits to total deposits
25. Ratio of priority sector advance to total advance
26. Ratio of term loans to total advances
27. Ratio of secured advance to total advance
28. Asset quality
29. Gross NPA to gross advance
30. GNPA to total assets
31. Capital adequacy ratio
32. Net NPA to net advance

1.12 Limitations of the Study

Even though this study is extensive and unique in many respects, it suffers from the following limitations.

1. SMGB has changed its loan categorization since the financial year 2007-08, in accordance with the MSMED ACT 2006, which has influenced the study of the last two years.

2. The managers and field officers were reluctant to supply even free information due to the lack of proper authentication from the head office.

3. Some of the managers were busily engaged with the jobs connected with their shifting to core banking climate.

4. Most of the respondents especially those from the farm sector did not have were not in the habit of keeping proper accounts of even their receipt and payments so their opinion on certain aspects may not be precise.

5. The response from the SHGs is given by their office bearers but the ultimate borrowers are very likely to have a different opinion.

6. There were minor variations in the secondary data on similar events in
different publications.

7. In spite of the above limitations, every effort has been made to make the analysis scientific and meaningful so as to arrive at accurate conclusion and to offer some valid suggestions.

1.13 Presentation of the Study

The study report is presented in six chapters.

Chapter 1: Introduction
Chapter 2: Rural Banking - A Theoretical Review
Chapter 3: Measures of SMGB for the Promotion of Agriculture, Industry and Service
Chapter 4: Effects of Promotional Measures on the Socio-economic Status of Beneficiaries
Chapter 5: Operational and Financial Performance of SMGB
Chapter 6: Summary of Findings, Conclusion and Suggestions