# CHAPTER-2

## REGIONAL RURAL BANK: AN OVERVIEW

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CHAPTER-2
REGIONAL RURAL BANKS: AN OVERVIEW

2.1 Introduction
Regional Rural Banks have a special place in the multi agency approach adopted to provide agricultural and rural credit in India. This chapter gives an overview of Regional Rural Banks in the context of the present study.

2.2 Rural Development in India
India is land of villages, nearly 72 percent of the Indian population lives in rural areas and in the year 2006-07 about 18.5 percent of the country’s national income was derived from agriculture. According to world development report 59 percent of male and 74 percent of female labour in India still depend on agriculture where as highly developed countries the percentage are only 5 and 4 respectively. The poor in rural India own little or no property and hence have no economic power. The major asset the poor possess is their labour power¹.

In a developing country like India, where wealth and poverty exist side by side, a small minority enjoys excessive riches while the vast majority has only the barest necessities of life and sometimes not even that².

Since its inception in March 14, 1950 the planning commission has given to the nation 12 Five Years Plans and six Annual Plans. The sole aim of all these plans was not only to allocate resources but also to germinate the seed of change for economic growth and simultaneously equitable distribution income as well as to achieve progress and prosperity in all spheres of life. Removal of poverty, hunger, ill health and dichotomies are still the relevant issues for socio economic planning in India³.

The broad views about rural development consider it as synonymous to agricultural development, promotion of the welfare or rural community, satisfaction of basic needs of the rural population, structural transformation of the rural society and an integrated process of achieving higher living standards in the rural areas⁴.

Rural development is at the top of the agenda in national policies of developing countries. Rural Development as a concept has been variously defined and interpreted. In the past Rural Development was often considered synonymous with agricultural development. In
India, during the sixties, agriculture became the nucleus of developmental activities but extensive concern with agricultural development created disparities and inequalities which ran counter to the basic objectives of Rural Development. However in recent years Rural Development has transcended the area of agricultural development and is looked upon in national development plans in a broader perspective. In fact Rural Development is wider in scope and deeper in impact. It is essentially concerned with improvement of living standard of the low income population in rural areas on self sustaining basis transforming the socio-spatial structure of their Productive activities. Further it implies a broad based reorganization mobilization of rural masses so as to enhance their capacity to cope effectively with the daily task of their lives and with changes consequent upon this.

The Rural Development sector policy paper of Bank (1975) observed that "Rural development is a strategy designed to improve the economic and social life of a specific group of people- the rural poor". It involves, extending the benefits of development to the poorest among those who seek a livelihood in the rural areas. The group includes small-scale farmers, tenants and the landless.

The Asian Centre for Development Administration (ACDA) gives a comprehensive definition of rural development in the context of Asian countries. ACDA defines rural development as "a process which leads to a continuous rise in the capacity of rural people to control their environment accompanied by a distribution of benefits resulting from such control."

Emphasizing the operational overtone, S.K. Sharma (1991) defines Rural development as consisting of "strategies, policies and programmes for the development of rural areas and the promotion of activities carried out in such areas (agriculture, forestry, fisheries, rural crafts, industries, supply of social infrastructure housing, village planning, public health, education) with the ultimate aim of accelerating the agricultural production, properly utilizing available physical, natural and human resources, and achieving higher income and better living conditions for the rural population as a whole, particularly the rural poor and effective participation of the latter in the development process with the ultimate aim of creating conditions for a self-sustained growth". According to Katarsing (1986) rural development connotes over all development of rural areas with a view to improving the quality of life of the rural people.
2.3 Institutional Credit for Rural Development

Banking is a major instrument for socio-economic transformation aiming at minimum rich poor disparity. Banking is the backbone of the economy. No business, trade or commerce can be conducted on large scale without an official banking system.

Banks in India till the mid sixties were mainly urban oriented and in terms of their activity they were hardly better than money lending business. The urban origin and profit cum security orientation of banks has restricted their operation mainly to commercial and industrial sectors. Fear of risk and loss led to instance on security and thus put a clamp on the ability of the banks to cover the neglected and weaker sections. It was very difficult in such an atmosphere for a small entrepreneur or a small farmer to produce credit even if in a viable scheme. No wonder agriculture which employs 70 percent of the labour force and contributed above 50 percent of the national income got only 2 percent of the total bank credit during 1950s

Realizing the gravity of rural credit problem the Government of India soon after independence formulated the rural credit policy which aimed at enhancing the role of institutional credit and reducing correspondingly the role of non institutional agencies. A large no of institutions have been set up to achieve the main objective of national credit policy i.e. development through credit.

The strategy of developing rural financial services was a three pronged one, consisting of (a) expansion of institutional structure (b) direct lending and (c) concessional and subsidized credit. This approach has ushered in an impressive growth of rural banking in India over the last three decades in terms of outreach credit disbursement and support to poverty alleviation programmes.

2.4 Regional Rural Banks- An overview

As mentioned, since the dawn of planning era in India, one of the primary objectives of the Government has been to streamline and strengthen its rural economy and to uplift standards of living of the weaker sections. For the fulfillment of this objective, apart from other agencies, banking institution are expected to play a dynamic role. Despite the combined efforts of the Co-operative and the Commercial Banks, the degree of institutionalization of rural credit was around 30 percent by the Nineteen Seventies. It is
unevenly distributed among the different size – groups of farmers and strata of rural society. The need for an institutional agency which could combine the rural co-operative and the business skill of commercial banks was increasingly felt.\textsuperscript{12} The rural people have been depending upon the non-institutional credit sources which have been exploiting them in several ways. This could only be avoided by providing institutional credit. Provisions of institutional finance ‘no doubt’ will play an important role in bringing about socio-economic changes among the rural population. In the absence of adequate and timely credit facilities from the institutions, private agencies dominate naturally rural credit scene. The nationalization of major Commercial Banks extended benefits mostly to the richer sections of the rural areas. Moreover, the savings mobilized from the rural areas have flown into urban and metropolitan areas and not to meet the needs of the weaker section of the rural community. Therefore, there is a widely shared view that a more determined effort was need to speed-up the flow of institutional credit, especially to meet the needs of the weaker sections of the rural community.\textsuperscript{13} The proposal for setting up some sort of ‘rural bank’ was first mooted by the Banking Commission in its report in 1972. The Banking Commission was appointed by the Union Government of India in February 1969 with a view to have a comprehensive review of the structure & operations of Commercial Banks in the totality of the working of the existing credit institutions in India and to suggest various measures for reorganizing the commercial banking structure for improving it’s functioning. The terms of reference of this commission included the review of the ‘working of co-operative banks and to make recommendations with a view to ensuring a coordinated development of commercial and co-operative banks’ particularly in the context of its ‘recommendations for extending the geographical and functional coverage of the commercial banking system’.\textsuperscript{14} After examining the record of the expansion of the commercial banks’ activities in their rural areas and their limitations, the banking commission expressed serious doubts on the capabilities of commercial banks for giving adequate coverage to the rural seats in the foreseeable future. It was the opinion of this commission that ‘in large and complex situation in the field of rural credit in India, there will remain a large gap even after the maximum possible branch expansion has been tried by the commercial banks’. This ‘gap’ was interpreted by it not only in quantitative terms for meeting needs of rural credit but
also for spreading banking in all rural areas for developing banking habits in the countryside. It further stated that there cannot be ‘any one solution to this extensive residual problem and all possible alternatives should be tried’. In this context, it proposed the establishment of a new class of ‘rural banks’ in areas ‘where The Co-operative Credit Structure is generally weak’. According to the Banking Commission, such ‘rural banks’ could be created in one of three possible ways:

i By converting selected viable primary agriculture societies into ‘rural co-operative banks’ offering a full range of banking as well as certain closely allied non-banking services

Or

ii By structuring a good primary agricultural credit society as a subsidiary of a commercial banks

Or

iii A commercial bank setting up its own subsidiary.

A rural bank created in the second and third ways listed here was to be called ‘rural subsidiary bank’ for distinguishing it from the rural co-operative bank created in the first way. It was envisaged that 51 percent of the capital of a rural subsidiary bank will held by the sponsoring bank and the balance by the people in the area of its operation. It was further stipulated that the rural banks- whether rural co-operative banks or rural subsidiary banks will extend credit and all other banking facilitates not only to their own local areas of operation by creating a new class of ‘associate member’. The proportion of credit to be given to the members and other conditions for granting such credit may be fixed in advance at more favorable terms than the associate members. In the view of the commission, it should be possible to organize rural banks for a compact group of villages covering a population ranging from say, 5,000 to 20,000. But ‘in sparsely populated areas, it may be necessary to organize a rural bank for as big an area as a development block to start with’.

The banking commission presented further details of its proposal for establishing a chain of such ‘rural banks’ such as the capital structure, dividend policy for share holders, interest policy, deposit insurance, linkages with other government bodies; link the food corporation of India, in terms of its procurement functions in rural areas, terms of
borrowing, minimum requirements of liquidity to be prescribed, etc. Recognizing the practical difficulties which would be encountered in starting rural banks, it laid down priorities for opening such banks and a phased expansion plan for their expansion. Specifically, it recommended that only a very limited number of rural banks which would be subsidiaries of commercial banks should be set up during an initial experimental phase of 5 years.\(^{16}\)

The banking commission’s concept of rural bank was designed to meet the full credit needs of all minimum and small cultivators. This kind of bank may not be in a position to meet the needs of certain cultivators and other rural producers for different types of technical help and for a much larger volume of loans as these may be beyond its capacity to provide. The commission recommended that such procedures should have access to a branch of commercial banks.\(^{17}\)

No action was taken by the government of India on the banking commission’s proposal for establishing a chain of rural banks. It was not until after the middle of June 1975 that policy makers in the Government of India felt any need for setting up same kind of new institution of rural banks for providing rural credit. The opportunity for such rethinking was provided by the so-called ‘twenty point program’ on 1 July 1975. Some of the points of this program specifically aimed at ameliorating the lot of the weaker sections of the rural society. The most direct of these points having a bearing on the rural credit scene related to a ‘plan for liquidation of rural indebtedness; legislation for moratorium on recovery of debt from landless laborers, small farmers and rural artisans’. In July 1975, the Government of India issued guidelines to the state governments to the effect that appropriate legislative action should be taken to ensure that all the debts of marginal farmers holding up to 2.5 acres of un-irrigated land should be taken as totally discharged and those of small farmers holding between 2.5 and 5 acres of such land should be scaled down. Also, it was suggested that a moratorium on the recovery of debts through the courts should be declared for both the categories of farmers just mentioned for a period of one year. It was further suggested that the debts of those holding irrigated land should be scaled down as per currently defined conversion ratios (between holding of irrigated v. non irrigated land) in the state in question. In pursuance of these guidelines, several state government enacted legislation for a moratorium, discharge and scaling down of the
debts from the non institutional sources of the small and marginal farmers landless laborers, rural artisans and other weaker section of the rural society. Such legislation was already expected to create a vacuum for meeting both the production and consumption credit of the weaker sections of the society as the traditional sources of credit were either going to dry up or would demand extraordinary high rates of interest on loans to cover the risk of non-payment within the preview of the law. Thus, the government of India seriously considered devising new alternative sources of credit to meet the requirements of the weaker section of the rural society. In this context the government of India felt that it was necessary to establish rural banks as new institutions on the basis of attitudinal and operational ethos different from those obtaining in the public sector banks.\textsuperscript{18}

The idea of new rural banks was inspired by consideration of lowering the cost of rural banking and operating such banks with local staff in an environment which the poor people in villages would find most homely. Implicit in the government of India thinking was an awareness that the weaker sections of the rural society had in general not benefited much from the existing credit institutions and that the new institutions of rural banks must rectify this deficiency and work for the rural poor.\textsuperscript{19}

The Government of India conceived the idea of setting up rural banks as part of the new economic programme. In order to further rationalize and operationalize this idea, the Government of India appointed a working group on rural bank under the chairmanship of M. Narsimham to examine in depth the setting up of new rural bank as subsidiaries of public sector banks to cater to the credit needs of the rural people. This working group was appointed on 1\textsuperscript{st} July 1975 and was asked to submit its report within short period of one month. The report was submitted by the working group on 31\textsuperscript{st} July 1975.\textsuperscript{20}

The regional rural banks were first set up by the Government of India in October 1975. They were largely based on the scheme recommended by the working group on rural banks. It would therefore be worth while providing a summery view of the major recommendations of this working group on this subject as a background for explaining of the major features of the regional rural banks act adopted by Government of India and to contrast them with the recommendation of the working group.\textsuperscript{21}
The Narsimham committee conceptualized the creation of Regional Rural Banks in 1975, as institutions which “combine the local feel and the familiarity with rural problems which the cooperatives possess and the degree of business organization, ability to mobilize deposits, access to central money markets and modernized outlook which the commercial banks have”\textsuperscript{22}

2.4.1 Features of the scheme for RRB\textsuperscript{23}

The Regional Rural Bank was set up under the Regional Rural Bank, 1975, promulgated by the president of India on 20 September 1975. This was subsequently replaced by the Regional Rural Bank act 1976 in February 1976. The main features of the scheme for setting up the Regional Rural Bank as adopted by the government of India are as follows.

1. Objective

The Regional Rural Bank act of 1976 is provided for the incorporation, regulation and winding up of Regional Rural Bank. According to this act, the Regional Rural Banks were to be setup mainly “with a view to developing the rural economy by providing, for the purposes of development of agriculture, trade, commerce, industries and other productive activities in the rural areas, credit and other facilities, particularly to the small and marginal farmers, agricultural labourers, artisans and small entrepreneurs and for matters connected therewith and incidental there to”.

2. Jurisdiction

Each Regional Rural Bank will operate within specified districts in a state and operate branches within local limits specified within a district. Generally the Regional Rural Bank for its area of operation will have a compact area of one to five districts with homogeneity in agro climatic condition and rural clientele. Its branch office wills generally cover one to three blocks and be in a position to finance five to ten farmer service societies.

3. Sponsorship

Each Regional Rural Bank will be sponsored by a scheduled commercial bank (mainly by a public sector bank). It will be set up at the initiative taken by the concerned state government and the central government and under license from
RBI. The sponsor bank will provide assistance to the Regional Rural Bank in several ways. These include subscription to its share capital, provision of managerial and other staff assistance to be mutually agreed upon within the period of first five years of its existence on mutually negotiable terms.

4. **Capital structure**

The authorized share capital of each RRB would be Rs. 1 crore and the issued capital would be Rs. 25 lakhs. The issued capital would be subscribed by the government of India, the sponsoring bank and the concerned state government in the proportion of 50 percent, 35 percent and 15 percent respectively.

5. **Management structure**

The management of each RRB will be through a nine member board of directors headed by a chairman. The strength of the board could be raised to 15 with the approval of the government of India which appoints the chairman. The central government nominates three directors (in addition to the chairman), the state government two directors, while the sponsoring bank nominates the balance of three directors. The remuneration paid to the staff directly recruited by the RRBs is prescribed by the government of India. The structure of the remuneration is uniformly lower than the structure applicable to the staff of the sponsoring commercial bank. The government of India has laid down that the structure of remuneration payable to the staff of the RRB should be par with the salary structure of the employee of the state government and local authorities of comparable level and status in the area of the RRB.

6. **Training of RRB staff**

Recognizing the need of the creation of a cadre of trained staff for the RRBs, the RBI would arrange Bank of India’s college of agricultural banking, Pune. The latter would provide help to the RRBs through the zonal training centers of their sponsoring bank for training programmes for the clerical and field staff of the RRBs.

7. **Banking business**

Every RRBs has the status of a schedule commercial bank and has been empowered to mobilize deposits and to grant short term and medium term loans
directly only to the small and marginal farmers, agricultural laborers, rural artisans, small entrepreneurs and persons of small means engaged in any productive activity and also (indirectly) to all types of cooperative societies and the farmers service societies operating within its area of jurisdiction. The RRBs can also provide loans both for production and consumption.

8. **Special privileges**

The RRBs are empowered to advance loan for productive as well as for consumption purposes. The RRBs can pay interest on deposits at the rates higher than the rates payable by the Scheduled Commercial Banks by 0.5 percent. Its lending rate will be at par with that of co-operatives. The RRBs can avail of refinancing facilities from the NABARD. They would get funds from NABARD at concessional rates of interest i.e. below the bank rate. In addition to these, under the RRBs act, the RRBs have been treated as equivalent in status to the co-operatives for the purpose of income tax benefits.

**Regional Rural Banks Act-1976**

Accepting the recommendation of the working group, the government of India promulgated the Regional Rural Banks ordinance on September 26, 1975 and first five RRBs were established by the RRBs Act 1976. The RRBs were to be set up mainly “with view to developing the rural economy by providing credit and other facilities for the purpose of development of agriculture, trade, commerce, industry and other productive activities in the rural areas particularly to the small and marginal farmers, agricultural labours, artisans, and small entrepreneurs”. The operational areas of RRBs are relatively small and confining to the specified area. The staff of RRBs is expected to be recruited locally. This would mean that the staff is familiar with the local language and environment the RRBs have been evolved as “low cost and rural based institutions and therefore eminently suited to implement bankable scheme in the rural areas”. The management of each RRB is to be through the board of directors consisting of 9-12 members headed by a chairman. The chairman is to be appointed by the government of India on the recommendations of the sponsor banks. The sponsor bank normally recommends a person from among its own employee for this position and they would be on deputation with the RRBs. The central government nominates three directors in
addition to the chairman. The state government nominates two directors, while the sponsor bank nominates the remaining three directors. The chairman is required to devote his whole time to the superintendence control and direction of the board of directors. He will look after the whole management of the RRBs.

Each RRB is expected to cover a population ranging from 5000 to 20000. Though the RRBs were set up with a view to bring out overall development of the rural areas, the main emphasis is on assisting the small farmers in obtaining the required inputs and in extending financial help other help required by them. With the establishment of RRBs the bank branches were spread to even the remote areas which are again a boon of those who want to avail benefits. The sponsoring bank will also help the RRBs in several ways. To start with, the sponsoring bank will meant the initial expenditure in the establishment of RRB. It deputes it staff and also arranges for appointment and training of the personnel. Sponsoring bank is like a guide, friend and philosopher to the RRB. RRBs are also provided with insurance coverage for the deposits to the maximum extent of Rs. 30000 per account.

2.5 Chapter concluding notes

This chapter gave an overview of Regional Rural Banks, its evolution and how it is important as a multi agency approach for rural development. The next chapter gives highlights of performance of Regional Rural Banks in India in terms of branch network, deposit mobilization, credit facilities and profitability from inception to year 2013.

End note

1 Agrawal, Babita, Regional Rural Banks as Rural Development in India, New Century Publications, New Delhi, 2009 p.1
2 Ibid, p.1
3 Ibid, p.2
4 Ibid, p.3
5 Ibid, p. 4
6 Ibid, p.4
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13 Ibid, p.11
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16 Ibid, p.12
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18 Ibid, p.13
19 Ibid, p.13
20 Ibid, p.14
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22 Meenakshi Madan, Regional Rural Banks and Inclusive Growth, New Century Publications, New Delhi, 2009 p.166