## CHAPTER-4

**PERFORMANCE OF REGIONAL RURAL BANKS - LITERATURE REVIEW**

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CHAPTER-4
PERFORMANCE OF REGIONAL RURAL BANKS-
LITERATURE REVIEW

4.1 Introduction
In this chapter various studies done on Regional Rural Banks in India are briefly described.

4.2 Literature Review of Regional Rural Banks
A number of studies have been conducted to see the functioning and performance of RRBs in the country. Some of the relevant studies are given here under.

4.2.1 Inception and growth phase (1976-1990)

Dantwala Committee (1978)\(^1\) made a study entitled “Report of committee on Regional Rural Banks” after reviewing the performance and potential strength of the Regional Rural Banks. The committee recommended that the government of India should take steps to make RRBs an integral part of the rural credit structure and concluded that within a short period of two years, the Regional Rural Banks have demonstrated their capability to serve the purpose for which they were established.

C.D. Wadhva (1980)\(^2\) made a noteworthy study, entitled “Rural Banks for Rural Development”. This study covered an analysis of the progress made by all Regional Rural Banks in India and offered valuable suggestions for the restructuring of the Regional Rural Banks. This study was conducted in 1977 when the Regional Rural Banks were in the initial stages and the assessment of their performance was premature.

The Kelkar Committee (1986)\(^3\) to strengthen RRBs further, Kelkar Committee made comprehensive recommendations covering both organizational and operational aspects. Several of these were incorporated as amendment the RRB Act, 1976 such as;

1. Enhancement of authorized capital of RRBs from Rs 1 crore to Rs 5 crore and paid up share capital from Rs 25 lakhs to Rs 1 crore;
2. Appointment of Chairman of RRBs by the concerned sponsor bank in consultation with NABARD;
3. Provision of assistance to RRBs in greater measure by sponsor banks in training RRB staff and giving financial assistance to RRBs in their first five years of existence
4. Provision for amalgamation of RRBs in consultation with all the concerned parties
5. Empowering the sponsor banks to monitor the progress of RRBs and also to arrange for their inspection, internal audit etc.

Though the progress of implementation was tardy (the amended act came into force only by end-September-1988), there was enough scope for improvement thereon.

**NABARD (1986)** published "A study on RRBs viability", which was conducted by Agriculture Finance Corporation in 1986 on behalf of NABARD. The study revealed that viability of RRBs was essentially dependent upon the fund management strategy, margin between resources mobility and their deployment and on the control exercised on current and future costs with advances. The proportion of the establishment costs to total cost and expansion of branches were the critical factors, which affected their viability. The study further concluded that RRBs incurred losses due to defects in their systems as such, there was need to rectify these and make them viable. The main suggestions of the study included improvement in the infrastructure facilities and opening of branches by commercial banks in such areas where RRBs were already in function.

**Agricultural Credit Review Committee- Khusro Committee (1989)** pointed out that Regional Rural Banks (RRBs) were facing certain problems as the financial health of Regional Rural Banks (RRBs) turned weak mainly due to its limited business flexibility with hardly any scope of expansion/diversification. The loan size was small with higher exposure to risk-prone advances and there was professional inefficiency in financial deployment. To strengthen Regional Rural Banks (RRBs) and improve their performance, the Reserve Bank allowed Regional Rural Banks (RRBs) to lend to non-target groups. Reserve Bank of India (RBI) deregulated their deposit and lending rates and permitted investment of their surplus funds into profitable avenues. Regional Rural Banks (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.

**Bapna (1989)** made study entitled “Regional Rural Banks in Rajasthan”. The study evaluated the working and growth of the 4 RRBs which were operating in Rajasthan in the year 1980. The aspects emphasized upon the organization, management, financial resources, loans and advances, credit deposit ratio, recovery performance
and profitability of RRBs. The study concluded that the RRBs suffered from many structural drawbacks and were economically unviable. It was found that the performance of RRBs with regard to branch expansion, deposit mobilization, building up of sizable trained human resources and meeting all commitments under the government sponsored programmes during the period under study had been satisfactory. The inherent weaknesses of the RRBs highlighted were mounting overdue and very low spread ratio and high burden ratio.

S.G. Hundekar (1995) made a study on “Productivity in banks”. The study aimed at analyzing the productivity of the Bijapur Gramin Bank in Karnataka State from 1976 to 1990, in terms of its growth, its innovative ability, achievement of social objectives and its operational efficiency & profitability of working funds. The productivity of RRBs is analyzed with help of market share in branch expansion, deposit mobilizing, credit management, operational efficiency, profitability ratios.

A. K. Jai Prakash (1996) studied on “Role of RRBs in Economic Development” the author conducted a study with the objective of analyzing the role of RRBs in Economic Development and revealed that RRBs have been playing a vital role in the field of rural development. Moreover, RRBs were more efficient in disbursal of loans to the rural borrowers as compared to the commercial banks. Support from the state Governments, local participation, and proper supervision of loans and opening urban branches were some steps recommended to make RRBs further efficient.

Himansu Shekhar (1997) made study on “Analysis and interpretation of the working of Regional Rural Banks”. The study was focus on the analysis and interpretation of the working of Regional Rural Banks in the domain of rural credit in India. Special attention has been paid to evaluate the economic development made by Regional Rural Banks in Bihar. The study also focused on various problems and prospects of Regional Rural Banks in India and particularly in Bihar. It covered the period of 1976 to 1985.

4.2.2 Reform phase (1991-2005)

Narasimham Committee (1991) The Committee on Financial Systems stressed the poor financial health of the RRBs to the exclusion of every other performance indicator. 172 of the 196 RRBS were recorded unprofitable with an aggregate loan recovery performance of 40.8 percent. (June 1993). The low equity base of these banks (paid up capital of Rs. 25 lakh) did not cover for the loan losses of most RRBs.
In the case of a few RRB there had also been an erosion of public deposits, besides capital. In order to impart viability the operations of RRBs, the Narasimham Committee suggested that the RRBs should be permitted to engage in all types of banking business and should not be forced to restrict their operations to the target groups, a proposal which was readily accepted. This recommendation marked a major turning point in the function of RRBs.

Kaur (1999)\(^{11}\) studied the growth and performance of RRBs in Punjab during the period 1987-96. The study revealed that RRBs had the highest growth rate of 5.11 percent in the rural areas. Deposit per branch, credit deployment, growth of credit deployment in the rural areas and semi urban areas, credit per branch, priority sector advances were the highest for RRBs as compared to those of commercial banks and cooperative banks in the rural areas in Punjab during the study period. Credit-Deposit ratio remained below the national average for commercial banks and RRBs during the same period.

Chavan and Pallavi (2004)\(^{12}\) have examined the Growth and Regional distribution of Rural Banking over the period 1975-2002. Chavan’s paper documents the gains made by historical underprivileged region of east, northeast and central part of India during the period of social and development banking. These gains were reversed in the 1990s cutbacks in rural branches in rural credit deposits ratios were the steepest in the eastern and northeastern states of India. Policies of financial liberalization have unmistakably worsened regional inequalities in rural banking in India.

Vyas committee (2004)\(^{13}\) the advisory committee on Flow of Credit to Agriculture and Related activities in June 2004 recommended restructuring of RRBs. Following this, an internal working group on RRBs was set up in the RBI to examine various alternatives available within the existing legal frame work for strengthening RRBs. In order to improve the viability of RRBs and take advantage of the economies of scale, the route of merger/amalgamation of RRBs were suggested taking in to the views of various stake holders. A two phase restructuring was suggested by the committee, (i) merger between RRBs of the same sponsor bank in the same state; and (ii) merger of RRBs sponsored by different banks in the same state.

Pal and Sura (2006)\(^{14}\) made a study on “Efficacy of Regional Rural Banks in India: A Conventional Analysis”. The study was based on 196 RRBs operating in India. The study made an attempt to assess the efficacy of RRBs in India for the period of 1975-2005. An attempt had been made to assess the efficacy of Regional Rural Banks in

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\(^{11}\) Kaur (1999)

\(^{12}\) Chavan and Pallavi (2004)

\(^{13}\) Vyas committee (2004)

\(^{14}\) Pal and Sura (2006)
terms of certain defined parameters like growth pattern of RRBs; the credit distribution of RRBs; and the geographical distribution of RRBs and to recommend some workable suggestions to augment the performance of RRBs in India. The study concluded that the overall position of RRBs in India was not quite encouraging. The government should spread the branches of RRBs at grass root level to provide such banking services to the really needy rural people.

Chidambaram (2007) examined that RRBs in India made considerable progress in deposit mobilization, credit dispensation and profit making during the period 2002-03 to 2004-05. It was mentioned that as a result of amalgamation, RRBs were in a position to provide better customer services with better infrastructure and policies of experienced staff. It further stressed upon the need for a change in the attitude of branch managers of the RRBs.

In the wake of introduction of financial sector reforms in 1991-92, the commercial viability of RRBs emerged as the most crucial factor in deciding about their desired role due to their limited business flexibility with hardly any scope of expansion/diversification, smaller size of loans with higher exposure to risk-prone advances and professional efficiency in financial deployment. To strengthen RRBs and improve their performance many initiatives have been taken by the Government of India and the Reserve Bank of India (RBI). As part of the comprehensive restructuring programme, recapitalization of RRBs was initiated in the year 1994-95. The process continued till 1999-00 and covered 187 RRBs with aggregate financial support of Rs.2188.44 crore from the shareholders, viz., Government of India, State Governments and sponsor Banks in the ratio of 50:15:35. Further, the branch licensing policy for RRBs has been liberalized. Under the new norms empowered committees at the regional offices of RBI clear RRB application to open new branches. The branches of RRBs may undertake government business including conducting foreign exchange business with the prior approval of the concerned Government authority and RBI. These banks have also been allowed to open extension counters at the premises of the institutions of which they are principal bankers after obtaining license from the concerned regional office of the RBI. The RRBs need not obtain permission of RBI for the installation of ATMs at the branches and extension counters for which they hold licenses issued by RBI. They are also permitted to open off-site ATMs after assessing the cost and benefit. As against the earlier policy of opening a large number of branches in far flung rural areas, RRBs
have been permitted to merge/close down their unviable branches and the branch licensing policy for RRBs is almost at par with that for commercial banks. Now RRBs compete with the commercial banks in rural credit market of India. RRBs give loans for agriculture and rural development while commercial banks also serve needs of commerce and industry in rural areas\(^\text{16}\).

The reform phase supplanted this understanding with a singular focus on commercial profitability for the Regional Rural Banks. In a sense, the reforms of the Regional Rural Banks were no different from the reforms of the commercial banks. The same set of policies was implemented and the same set of standards set to calibrate then-performance. Not surprisingly then, the Regional Rural Banks started aping the commercial banks in their activities-banks relocated to more promising areas; investments in government securities and PSU bonds and debentures increased while banks were hesitant to increase their loan portfolios; credit was extended mainly under non-priority sector heads so that the proportion of priority sector loans declined despite the dilution of the priority sector definition in several ways; interest rates on lending were deregulated which resulted in high interest rates charged by the Regional Rural Banks; credit to deposit ratio became less than half of the pre-reform levels indicating increased net transfer of resources from the rural poor to the urban rich; regional imbalances aggravated; and the small borrowers, the Principal clients of the Regional Rural Banks were overwhelmingly sidelined. By the beginning of the present decade, the carefully built structure of rural development banking in India had all but collapsed.\(^\text{17}\)

### 4.2.3 Reconstruction/ post merger phase (2005 onwards)

By the year end March 2005, there was a remarkable improvement in the financial performance of RRBs as compared to the position prevailing in 2000-01. The numbers of RRBs reporting profit 166 out of 196 in 2004-05 as against 170 out of 196 in 2000-01. It is only in the past few years that the unwanted effects of reform measures on rural banking have begun to be recognized in certain official quarters. That the improved performance of the RRBs- 163 out of 196 RRBs were earning profits in 2003- 04 was largely a result of the banks abrogating their credit intermediation role rather than a sign of their genuine health and vibrancy is pitifully obvious\(^\text{18}\).
Based on the recommendation Vyas Committee (2004) the government of India initiated the process of structural consolidation of RRBs by amalgamating RRBs sponsored by the same bank within a state. So the current phase (2005 onwards) is a third phase of reform known as post merger period. After the amalgamation, the numbers of RRBs were reduced from 196 to 133 as 31st March 2006 and it is further reduced to 64 as on 31st March 2013.

**Measures to Improve Operational Efficiency**

With a view to improving the performance of RRBs and giving more powers and flexibility to their Board in decision making the RBI had constituted the task force on empowering the RRBs Board for operational efficiency under the chairmanship of Dr. K.G. Karmakar in September 2006. The task force was constituted to deliberate and suggest areas where more autonomy could be given to the Boards, particularly in matter of investment, business development and staffing viz. determination of staff strength, fresh recruitment and promotions among other. In its report submitted in January 31, 2007 the task force made several recommendations relating to operational flexibility of RRBs while some of the recommendations of task force are implemented, others are under examination. Some of the key recommendations of the above task force were as under

1. The no of directors on the board of RRBs be raised up to 15 on a selective basis in the case of large size RRBs created after amalgamation.
2. Selection of chairman of RRBs is on merit from amongst a panel of qualifying officers.
3. Minimum tenure of board members be stipulated as two years, subject to a maximum of 5 years for the chairman.
4. The term of nominee directors should not exceed two terms of two years each.
5. Non-official directors on the Boards of RRBs need to be oriented towards the functions of RRBs and their responsibilities as nominee directors.
6. RRBs should be subjected to the same level of safeguards and regulatory norms regarding capital adequacy as and regulatory norms regarding capital adequacy as applicable to commercial banks after the process of amalgamation is over.
7. RRBs must have the following committees (i) Risk Management Committee; (ii) Management committee; (iii) Investments, Human resources and Information Technology Committee and (iv) Audit committee.
8. Chairmen of RRBs should also be appointed as a member of the Empowered Committee constituted by Reserve Bank.

9. Matters relating to categorization of branches, staffing norms and promotion policies and other HR matter's, may be studied in depth by a Committee/Task Force, set up for the purpose by the Reserve Bank/Government India.

10. RRBs need to take up computerization of major areas of operations, management information system (MIS) in branches, controlling offices and head office in the next 3 years by adopting an Action Plan.

11. RRBs may be allowed to deal in NRE/FCNR (B)/FCRA, certificates of deposits, among others. In consortium with sponsor bank and be given the freedom to place their money in term deposits with any bank.

12. RRBs may join in consortium finance with public sector banks' DFIs.

13. Securitization and Reconstruction of Financial assets and Enforcement of Security Interest Act, 2002 may be extended to RRBs.

14. Provisions under section 80(P) of the income tax act may be continued for a further of five years or till the restructuring process is completed, whichever is earlier.

Independent of official deliberations, the all Indian RRBs employees association (AIRRBEA) proposed that the RRBs be amalgamated to form zonal or state level RRBs. They have cited two strong reasons to make the case “the RRBs must be structured in to zonal or state level RRBs under any public sector apex banking institution or NABARD, so as to ensure the unity of command and cross subsidization as in any banking institution, if the central balance sheet is prepared at the apex level, the losses of the few RRBs (in the Eastern, North-Eastern and Central regions) can easily be taken care of with the huge aggregate profit of a majority of the RRBs”. Further, a national body like that of NABARD should monitor the activities of such RRBs. Opposing the demands of All-India RRB Officers Federation for amalgamation of RRBs with the sponsor banks as the only route to sustainability, AIRRBEA has demanded de-linking of the RRBs from the sponsor banks so as to ensure functional autonomy for the rural banks, and to relieve the burden of 'sole' commercial orientation so that the rural credit activities can be pursued more freely.

The AIRRBEA statement clearly takes the issue of ownership beyond the current preoccupation with profitability and asserts that not only can viability issues be handled better by restructuring the RRBs along the lines suggested by them, but more
importantly it can enable improved performance vis-a-vis credit activities, which is the urgent need today. The control of sponsor banks on the RRBs needs to be seriously revaluated. At a time when the sponsor banks are themselves constrained to make cuts in the manpower and credit to agriculture or the SSI sector, they are unable to extend the help to the RRBs on which their sponsorship was premised. In our view, it is necessary that along with the Vyas Committee recommendations, which have absolutely defined the post-merger banking structure in terms of state-level banks, the policy makers also take into consideration the legitimate demand for functional autonomy and to rid the RRBs of the ‘sole’ commercial orientation such that the present decline of rural banking might be reversed.21

As rightly said by Singh et al. (2009) the recent phase is about some repositioning to strike a balance in the conundrum of viability versus outreach. We have argued that the first phase while more focused on outreach was not devoid of a blueprint for viability, though the notion of viability for the RRBs was much more nuanced than what it denoted under the neo-liberal reform era. It is true that the commercial principles of banking were put under stress especially in the later part of the 1980s, which needed corrective steps and indeed many of the recommendations of that time were geared to improve recovery and reduce losses incurred by these banks. However, it was generally held that these improvements could be done (and had to be done) within the parameters set for the RRBs, which in turn were determined by the overall vision of rural banking. The reform phase supplanted this understanding with a singular focus on commercial profitability for the RRBs. In a sense, the reforms of the RRBs were no different from the reforms of the commercial banks. The same set of policies was implemented, and the same set of standards set to calibrate their performance. Not surprisingly then, the RRBs started aping the commercial banks in their activities-banks relocated to more promising areas; investments in government securities and PSU bonds and debentures increased while banks were hesitant to increase their loan portfolios; credit was extended mainly under non-priority sector heads so that the proportion of priority sector loans22 declined despite the dilution of the priority sector definition in several ways; interest rates on lending were deregulated which resulted in high interest rates charged by the RRBs; credit to deposit ratio became less than half of the pre-reform levels indicating increased net transfer of resources from the rural poor to the urban rich; regional imbalances aggravated; and the small borrowers, the principal clients of the RRBs
were overwhelmingly sidelined. By the beginning of the present decade, the carefully built structure of rural development banking in India had all but collapsed\textsuperscript{23}. In the past couple of years which we delineate as the third phase of Regional Rural Banking, there have been one or two hesitant moves towards correcting the gross excesses of reforms, such as the upward revision of the priority sector lending target to 60 percent of the total advances. Clearly, there is need for a much bolder approach. The minimum that needs to be done, immediately, is to implement the recommendations of the government’s own Estimates Committee (2002-03) fully so that both the volume of credit and the terms of credit to the rural areas and to the targeted population can begin to improve. More generally, the incentive environment currently in place, which forces banks to respect commercial viability ‘only’ without any obligation toward RRBs primary banking activities has to be urgently replaced. This doesn’t mean a return to the pre-reform era of banking, but rather moving towards a sensible blend of the ‘RRB innovation’ while pursuing a ‘nuanced’ criteria of viability, which must necessarily be different from the present benchmark of banking performance\textsuperscript{24}. 

**K.G. Karmakar (2007)\textsuperscript{25}** the Reserve Bank constituted the Task Force on Empowering the RRB boards for Operational Efficiency (chairman Dr. K.G. Karmakar) in September 2006. The Task Force was constituted to deliberate and suggest areas where more autonomy could be given to the board, particularly in matter of investment, business development and staffing. The Task Force submitted its report in January 2007. The Task Force recommended that the number of directors on the boards of RRBs be raised up to 15 on selective basis, selection of chairman should be on merit base, the term of nominee directors should not exceed two terms of two years each, RRBs should be subjected to the same level of safeguards and regulatory norms regarding capital adequacy as applicable to commercial banks after the process of amalgamation is over, chairman of RRBs should also be appointed as member of the Empowered Committee, RRBs need to take up computerization of major areas of operations within three years.

**Hemlata & Poonamsing (2009)\textsuperscript{26}** studied on “Financial inclusion through Regional Rural Banks”. The paper deals with role of Regional Rural Banks in financing, role in financial inclusion, mobilization of savings, micro finance, and self help promotion institutions. The study recommends that RRBs should extend their services in to unbanked areas and increase their credit deposit ratio. As RRBs with branch in
remote, interior and tribal-dominated areas, they have a special role to play financial inclusion.

**Ibrahim (2010)** made study on “Performance Evaluation of Regional Rural Banks in India”. The main objective of the study is to analyze whether the merger/amalgamation of RRBs in India, undertaken in 2005-06 has helped improve their performance. The study was confined only to the specific areas like number of branches, district coverage, deposits mobilized, credits and investments made by the Indian RRBs for period from 2001-02 to 2008-09. Various statistical tools like t test and ANOVA had been used in the study. The study observed that even though number of RRBs decreased, the branch network had increased and the performance of RRBs in India improved in the post amalgamation period.

**Makandar, N.M. (2010)** made study on “Profitability and Productivity Analysis of RRBs in India”. In the light of the amalgamation of RRBs in India the main purpose of this study is to investigate the efficiency of the sample RRBs in Karnataka state and to analyze the changes in profitability and productivity by comparing between pre and post amalgamation period. The study concluded that the profitability of the sample has not improved as expected but in long run one hope that the restructuring of the RRBs in India give positive result.

**Ishwar (2011)** conducted study on “A Financial Performance Analysis of RRBs: Pre and Post Transformation”. The study made an attempt to study the performance of the RRBs from 1980-81 to 2008-09. In order to know the implications of transformation of RRBs in 2004, the study focused on financial results before and after amalgamation. The findings of the study revel that after amalgamation, RRBs transformation had resulted in a 200 per cent increase in net profits, and a 100 per cent increase in business. There was a gradual reduction in the number of loss-making banks and addition of 1,000 outlets. All this had been because of consolidation among RRBs.

**Soni, A & Kapre A. (2011)** made study entitled “Performance Evaluation of Regional Rural Banks in India. The objectives of the study were to measure financial performance by key performance indicators, progress, growth, pattern and make important suggestions to improve the working of RRBs in India. The finding of the study revealed that the efforts made by RRBs in branch expansion, Deposit mobilization, rural development and credit deployment in weaker section of rural areas are appreciable. The RRBs successfully achieve its objectives like to take
banking to door steps of rural household particularly in banking deprived rural area, to avail easy and cheaper credit to weaker rural section who are dependent on private lenders, to encourage rural savings for productive activities, to generate employment in rural areas and to bring down the cost of purveying credit in rural areas. Thus RRBs is providing strongest banking network. Government should take some effective remedial steps to make rural banks viable.

**Bhatia, Arpana (2013)** made study on “Performance Evaluation of RRBs in India during Pre and Post merger period”. The overall objective of the study was to assess whether the amalgamation process in the Indian rural banking sector has been successful in restructuring the banks. The specific objectives of this study were to evaluate the performance and growth pattern of RRBs in terms of spread, burden, profitability and productivity over the period under study and weather the performance of RRBs significantly differ from pre and post amalgamation period. The study concluded that overall there is an improvement in the efficiency of RRBs in post merger period. The spread ratio, productivity and profitability of RRBs shows upward trend in post merger period and burden ratios were continuously diminishing after amalgamation period.

**Bhatt, K.A. (2013)** made study entitled “Profitability Analysis of Regional Rural Banks in India: with Special Reference to Western Region”. The study focused on western region of India i.e. Gujarat, Maharastra and Rajasthan. The study made an attempt to study the profitability analysis of the RRBs from 2007-08 to 2011-12. The main objectives of the study were to analyze the interest coverage ratio, to analyze the return on Equity, to examine non-interest income ratio and to study net interest margin ratio of selected RRBs during study period. The finding of the study revealed that selected bank of Rajasthan showed higher profitability then selected RRBs of Gujarat and Maharastra.

**Kanika & Nency (2013)** made study on “Financial Performance of Regional Rural Banks in India”. The increase in the amount of NPA’s and the problem recovery necessitated the need to study the financial performance of Regional Rural Banks. The main objective of the study was to know the growth pattern and financial performance of RRBs in India. The study covered a specific period from 2006-07 to 2011-12. The study concluded that the expansion of RRBs at a rapid rate helped in
reducing substantially the regional disparities in respect of banking facilities and RRBs also successfully achieve its objectives to serve rural people.

As observed by P.A Steeven Raj, 2009 the first phase while more focused on outreach was not devoid of a blueprint for viability, though the notion of viability for the Regional Rural Banks was much more nuanced than what it denoted under the neo-liberal reform era. It is true that the commercial principles of banking were put under stress, especially in the later part of the 1980s, which needed corrective steps, and indeed many of the policy recommendations of that time were geared to improve recovery and reduce losses incurred by these banks. However, it was generally held that these improvements could be done (and had to be done) within the parameters set for the Regional Rural Banks, which in turn were determined by the overall vision of rural banking 34.

4.3 Concluding Notes

This chapter gives us summaries of various studies according to three phases of RRBs on Performance of Regional Rural Banks in India by various researchers. The next chapter gives research methodology and profile of Regional Rural Banks in Gujarat.

End note

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