PREFACE

Until the mid nineties, the entire rural finance system was characterized by a lack of operational freedom due to all pervasive governmental intervention as well as the control of all aspects of the functioning of the institutions by the Reserve Bank of India (RBI), the Central Bank of the country. From the mid-1950s to the mid 1970s, the main concern of the government was to increase food production, but during the mid 1970s the focus shifted to poverty alleviation through subsidized credit. The predominant aim of policy makers from the 1950s to 1980s was to extend the outreach of the rural finance system and to increase the level of credit flow to agriculture and to poverty alleviation programs.

In 1975, the Regional Rural Banks (RRBs) were established as an innovative hybrid financial institution, combining the good features of cooperatives and commercial banks with a view to abridge the credit gap that existed in the rural sector and which, supposedly, could not be filled up by the then existing commercial banks or cooperative credit societies (Report of the Working Group on Rural Banking, 1975, Chaired by M. Narashimham). The RRBs served as low cost alternatives to commercial banks and cooperative banks to cater to the needs of rural credit under a separate statute – the Regional Rural Banks Act of 1976 (which was enacted by replacing the initial Ordinance promulgated by the president of India on 26th September, 1975). The conception of the RRB is unique one as it is under the joint venture of the central Government, the state Government and the sponsor bank with their capital share at a rate of 50%, 15% and 35% respectively.

The major objective of the RRBs, as articulated in the Regional Rural Banks Act of 1976, is to develop the rural economy by providing credit and other facilities for agriculture, trade, industry and other productive activities in the rural areas, particularly to the small and marginal farmers, agricultural labourers, artisans, and small entrepreneurs.

With a view to fulfill the assigned objectives, in the initial years, extension of outreach was given a major thrust and the RRBs, considered as ‘Poor Man’s Bank’ were encouraged to go for rapid expansion so as to provide institutional credit facilities to every nook and corner of the rural India. As a result, there was a massive increase in the number of RRBs from only 6 RRBs in 1975 to 188 in 1985 and further
to 196 in 1987. Though, after 1987, the total number of RRBs remained fixed at 196, the branch expansion continued. The number of total RRB branches in the country increased from only 17 in 1975 to 12606 in 1985 and to 14484 in 2004-05.

The RRBs as a whole disbursed Rs. 26068.57 crore as credit and mobilized deposits worth Rs. 62283.71 crore (as on 31st March 2005)*. These banks as a group had organised roughly 12 lakh self Help Groups in the country (45% of the total SHGs) and issued over 40 lakh Kisan Credit Cards to the Farmers.** They also acted as the financing agency for the social welfare oriented government sponsored programs for rural development like, Integrated Rural development programme (IRDP), Jawahar Rozgar Yojana (JRY), Swarnajyoti Gramin Rozgar Yojana (SGRY), Prime Minister’s Rozgar Yojana (PMRY), and so on. Thus, over the years the RRBs have taken a deep root and have become an inseparable component in the rural financial system of the country.

However, during its expansionary phase, while the RRBs were performing their assigned functions under the dictate of Government’s policies and programmes, the issues relating to the development of a proper banking system or an efficient rural financial market involving, proper loan appraisal, recovery and recycling, resource mobilization, sustainability and viability of the operations were, to some extent, overlooked.

As a result, despite their impressive geographic coverage and intermediation activities, the RRBs, a major component of rural financial system, not only experienced poor financial health over the years but also continued to be functioning with a poor resource base, high transaction cost, low or negative margins, mounting bad debts, and continuous losses. For majority of the RRBs, the high level of NPAs has been a major stumbling block to attain profitability and solvency. The mismanagement of assets and liabilities made the condition of RRBs bad to worse.

In the very first decade of the setting up of RRBs, 152 out of 188 RRBs had accumulated losses of Rs 340 crore. The losses surged sharply in 1992 on account of implementation of the National Industrial Tribunal Award (NITA) bringing parity in wage structure of RRBs with that of commercial banks. This has negated the low cost structure of RRBs and led to the accumulation of huge losses. In 1991-92 out of 196

* Reports on Trends and Progress of Banking in India, 2004-05, RBI
** Debate in the XV Lok Sabha on Regional Rural Bank amendment Bill, 2004
only 179 RRBs were found to run under losses. As on June 1993, 172 RRBs emerged as unprofitable with aggregate loan recovery performance at 40.8 percent only. During 1993-94, total accumulated losses of RRBs was to the tune of Rs. 1302 crore, which, at the end of the financial year 1994-95 increased to Rs. 1686 crore, implying that the RRBs as a whole incurred losses of more than Rs. 1 crore per day during the period.

Co-incidentally, during this period, the entire banking system of the country was being reengineered to create an operating environment wherein the banks and other financial institutions would have operational flexibility and functional autonomy. As a part of the process of liberalisation and globalisation of the whole economy, the banking sector reform measures were introduced in 1991-92 with a view to increase their efficiency, productivity and competitive strength by making institutional and regulatory changes, and providing, inter alia, operational flexibility, autonomy, and deregulation of interest rates.

By 1994-95 the situation in RRBs was hardly conducive to be an effective credit delivery system, especially in the context of the emerging competitive environment followed by the implementation of financial sector reforms. It was felt that the RRBs, with its present status could not meet the financial needs of the rural population without a complete overhauling of the existing system or the creation of an entirely new system, wherein, the RRBs would be sensitive to the concept of cost effectiveness and they would be commercially orientated with professionalism.

As a response to the dismal performance of RRBs, the Indian government and NABARD initiated corrective steps and implemented the banking reform measures in 1994-95 to make them productive, competitive and commercially viable. In 1995-96 the prudential norms of income recognition, asset classification and provisioning were also implemented. The NABARD started implementing development action plans (DAPs) for each of the rural finance institutions in 1994-95 also. A number of committees and working groups were also constituted to find out the ways and means to convert these institutions sustainably viable and conducive to the efficient credit delivery system.

The impact of these measures was augmented through infusions of fresh capital into the RRBs during late 1990s, to cover up the accumulated losses of the past. Over the period 1994-2000, 187 RRBs were provided with a total amount of
Rs.2188 crore for recapitalisation. With these initiatives, number of profitable RRBs increased from 46 in 1996 to 168 out of 196 during 2002. The aggregate loss of RRBs of the country as a whole was about Rs 581 crore in 1996 and with this turnaround, the RRBs made an aggregate profit of about Rs 610 crore in 2002. However; their financial viability continues to be overstretched by the lower capital base in an environment of inadequate infrastructure and deep social and economic disparities.

Further, the policy measures under the wave of liberalisation and global orientation of Indian economy, generally dictated by the ethos of financial viability, have diluted the outreach objective of RRBs. They have been allowed to relocate, merge or close down the loss-making branches with a view to renovate them as financially viable institutions. However, relocations or mergers were undertaken mostly from relatively inaccessible rural areas to more vibrant semi-urban or urban locations. Moreover, the licensing norms for opening new branches have been relaxed, so as to allow the RRBs to establish branches outside their designated districts of operation. Besides, the priority sector definition has also been diluted to widen the sphere of the sector and the obligations to lend to the priority sector has also been relaxed by allowing the RRBs to invest in Rural Infrastructural Development Fund (RIDF), to cover up the shortfall in priority sector lending.

Not only this, the RRBs have been allowed to carry out all types of banking activities at par with the nationalized commercial banks and to lend to the non-target group of borrowers, even beyond their earlier operational boundary. In order to reduce their transaction costs, the RRBs are shifting their focus to the big borrowers, giving relatively less importance to the small and marginal farmers, small traders, village artisans, and small entrepreneurs.

Another notable change in their operational policy is to shift their business to investment in capital market instead of lending in their operational area in order to reduce the risk of lending, and keep the NPA under control. This has resulted a sharp decline in the credit deposit ratio of these banks during the post reform period. Thus, under the changed environment with greater operational autonomy, market competition and deregulated interest rate regime, the RRBs are found to be moving away from their earlier objectives and operating with purely commercial motive of earning profit. Because of this, during the period following the implementation of
banking sector reforms, the differences between the RRBs and the other commercial banks is gradually been wiped out.

Thus, financial viability is of prime importance in the context of changing face of the rural credit delivery system. It is now an important determining factor whether these ‘Poor Man’s Bank’ would be capable of rendering services as a sound and healthy financial institution and as per the banking needs and aspirations of the rural clienteles.

However, in this context, it is noteworthy that the Grameen Bank of Bangladesh has proved that the poor are bankable and a bank can bring an end to their miseries of life of the rural poor and even remain economically viable by formulating appropriate lending strategies. Therefore, the success of RRBs in commercial terms or their financial viability largely depends on appropriate approach and suitable strategies to scale up their business levels, to achieve capacity utilisation and devise innovative ways to cater to the typical needs of the vast rural sector.

Again, the operational success and failure of RRBs in terms of their commercial profitability and financial viability vary among the RRBs depending on their operational policies and the quality of leadership of sponsor banks. At the same time, there is inter regional variation in financial viability of RRBs because of the prevailing economic condition of the regional economy, agro-climatic conditions, infrastructural bottlenecks, and so on. Therefore, the same strategy may not be equally applicable to solve the problems encountered by the different RRBs in different parts of the country. Hence, a proper scanning of the problems behind the non-viability of RRBs needs to be explored taking into considerations of all these regional specificities.

Under this backdrop, the present study entitled ‘Financial Viability and Profitability Problems of RRBs – An Empirical Study on South Assam” has been undertaken with a view to examine how far the RRB [the Assam Gramin Vikas Bank (AGVB), erstwhile Cachar Gramin Bank (CGB)] operating in the Barak Valley (comprising the three districts, viz., Cachar, Karimganj and Hailakandi in Southern Part of Assam) is equipped to face the challenges emanated from the banking sector reform and to exploit the opportunities ushered in the changing policies in rural banking scenario of the country.
The study is organized in seven chapters.

**The first chapter, Introductory;** is devoted to the statement of the problem, a brief introduction to the study area, extensive review of available literature, finding out the research gap, rationale of the study, objectives, conceptual framework, hypothesis, research methodology and limitations of the study. In the **Second Chapter** entitled 'Evolution of Rural Banking system in India (with special reference to RRBs) - a paradigm shift', a detailed analysis of the process of evolution of rural banking system in the country since pre-independence period has been made, with special emphasis on the genesis and evolution of regional rural banks. The chapter is designated to identify the areas of divergence in objectives and operational approaches of the RRBs in the post reform regime in comparison to that of the earlier period. An endeavour has been made to assess critically the financial performance of the RRB in the area under study in the **third chapter,** entitled, *Financial Performance of RRB in South Assam (Cachar Gramin Bank): A Critical Assessment*. Having been studied the performance of the bank on the basis of selected parameters, the fourth **chapter,** entitled, 'Profitability of RRB in the study area: Trend and Determinants' is entrusted to analyse the commercial efficiency in terms of profitability performance based on standard profitability indicators of the bank in the study area. The **fifth Chapter,** 'Derivatives of Financial Viability of RRB: an application of Principal Component Analysis' is assigned to analyse the determinants of financial viability from view point of operational efficiency, based on the widely used efficiency parameters. Besides, Principal Component Analysis was used to identify the relative significance of variables affecting the financial viability of the RRB under study.

As the customers are of prime importance for the success of a service industry, the **Sixth Chapter** entitled 'Service quality vis-à-vis Customers' Satisfaction in RRB: an Empirical study' was dedicated to assess the perception of customers about the quality of services rendered by the bank taking a set of widely used attributes into consideration. Principal Component Analysis was also applied to identify the factors influencing the level of customers' satisfaction. Finally, **Epilogue,** the **Seventh Chapter,** summarized the findings of entire study along with suggestions for further improvement in respect of the viability and profitability of the bank in the study area.
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