

# Profitability of Regional Rural Banks

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The origin of the Regional Rural Banks (RRBs) can be traced in the Regional Rural Banks Ordinance promulgated on 26<sup>th</sup> September, 1975 for establishment of five Regional Rural Banks in the country on 2<sup>nd</sup> October, 1975 followed by enactment of the Regional Rural Banks Act 1976 on 9<sup>th</sup> February, 1976 on the recommendations of the Narshimham Committee Working Group for providing banking services to the rural economy with focus on the underdeveloped far flung remote rural and tribal areas having objective of assimilating these segments with the mainstream of the economy as about 70% of the Indian population was of rural orientation. RRBs have capital support from Government of India, State Government and sponsoring Commercial Bank in the ratio of 50%, 15% and 35% respectively with operational, managerial and professional support from Sponsor Banks. The organizational and operational landscape of the RRBs has metamorphosed to a great extent during this eventful evolutionary journey of forty five odd years and can be segmented under three phases:

1. The first phase, from 1975 to 1991, has seen the phenomenal expansion of bank and branch network having 196 RRBs with branch network of 14,527 across the country. This phase focused on geographic expansion of the banking network.
2. The Second phase, between 1991 to 2004, can be termed as stabilization phase with focus on business development with number of RRBs remaining 196 but

3. slight reduction in branch network to 14,448. This phase focused mainly on business parameters through portfolio diversification both on asset and liability side.
3. The third phase during 2005 till 2020 can be termed as consolidation phase, wherein number of RRBs reduced to 43 on 01-04-2020 through three rounds of amalgamations but significant branch expansion has taken place taking tally of total branches to 21,850 to basically address the issues of financial inclusion.

This forty five year journey of Regional Rural Banks has been highly experimental and enriching as no other organization has seen such expansion and amalgamation phases in this manner. With this ongoing phase of amalgamation and consolidation of the RRBs, it has become imperative to analyze the profitability of RRBs as commercial organizations as every commercial organization must be financially viable for their long term survival and growth. With this objective in mind, an attempt has been made to analyze the financials of the RRBs of the last five years i.e. from March 2016 to March 2020 for better understanding of the financial health of these organizations. The major financial parameters of the RRBs of the last five years, drawn from the statistics published by National Bank for Agriculture and Rural Development (NABARD), are presented in Table I:

**Table I- Business Performance of RRBs- Key Parameters**

(Figures in Crores)

Sr No	Parameter/ Year	31.03.2016	31.03.2017	31.03.2018	31.03.2019	31.03.2020
1	No of RRBs	56	56	56	53	45*
2	Capital	6387	6401	6436	6735	7849
3	Reserves	20665	23080	25083	25398	26817
4	Accumulated Loss	1050	1147	1768	2887	6467
5	Deposits	313499	371910	400459	434444	478547
6	Gross Advances	206538	226175	253978	280755	298256
7	Gross NPA %	6.80	8.07	9.47	10.08	10.40
8	Net NPA %	4.23	5.06	5.90	6.80	5.70
9	Total Income	35446	39163	41818	42988	49452
9A	Interest Income	33340	35880	38337	38931	43698
9B	Other Income	2106	3283	3481	4057	5754
10	Total Expenses	33428	36945	40294	43639	51658
10 A	Interest Expenses	21713	23402	23868	23716	25985
10 B	Operating Expenses	9784	10386	10928	13803	18651
10 Ba	Of which Wage Bill	6870	6795	7044	9379	12843
11	Provisions	1931	3157	5498	6120	7021

12	Gross Profit	3949	5375	7022	5459	4523
13	Net Profit	2018	2218	1525	-652	-2206
14	RRBs in Profit	50	49	45	39	26
15	RRBs in Loss	6	7	11	14	19
16	Business Per Branch	24.86	27.92	30.50	33.10	35.60
17	Business Per Employee	5.90	6.91	7.29	7.70	8.50
18	Return on Assets (%)	0.53	0.51	0.32	-0.13	-0.40
19	CRAR %	12.80	13.00	12.40	11.50	10.20

\*As on 01-04-2020, the number of RRBs is 43.

The analyses of the above figures reveal that:

- Total income of the RRBs has risen by 39.51% during five year period. Interest Income during this period posted growth of 31.06% whereas other incomes have grown by 173.22%.
- Expenses during the five years have increased by 54.54%. Interest expense has registered growth of 19.67%, operating expenses have gone up by 90.63% and provisions have shown increase of 263.60% during the same period.
- Wage bill has registered alarming increase during this period from Rs 6870 Crs to Rs 12843 Crs during five year period.
- Gross and net NPA has been constantly on rise from 6.80% and 4.23% to 10.40% and 5.70% respectively during the period of analysis.
- Increasing NPAs and aging of NPAs has substantially increased provisioning requirements impacting the profitability adversely.
- Accumulated losses are continuously increasing from Rs 1050 Crs in March 2016 to Rs 6467 Crs in March 2020.
- Capital to risk weighted ratio (CRAR) is continuously decreasing from 12.80% as on March 2016 to 10.20% as on March 2020, which is inhibiting credit growth.
- Number of profit making banks have reduced from 50 to 26 during this period whereas loss making banks have increased from 6 to 19. The reduction in number of banks has been due to amalgamation of RRBs within the States.
- Overall business, per employee business and per branch business has shown consistent growth.
- Return on assets reduced from 0.53% in March 2016 to -0.40% in March 2020. The return on assets for the RRBs is negative for the last two years.

Analytical perspective requires systemic approach for decoding the observations of financial parameters with circumspection and positivity thereby providing the blueprint for future course of action with a view to make these banks financially viable for achieving their socio economic objectives in a proactive manner. These banks are serving to the population on the bottom of the pyramid, therefore their organizational relevance is critically important for serving the target segment in the national interest. For discharging their responsibility as commercial banks, these banks must become economically viable and commercially profitable. Therefore, an attempt is being made, at this juncture, to identify the major issues of concern, which can be classified as under:

- Structural Issues
- Legal and Administrative Issues

#### 1. Structural Issues

Regional Rural Banks, since inception, have been the subject of experimentation on various pretexts ranging from their

staff, activities and area of operation during their forty five odd years of existence. The RRBs, which started with the concept of one district, with local staff and state related salary structure thus having low cost structure with local feel, migrated to multi district operational area and in some cases state wide operational area, salary structure of public sector banks through intervention of tribunal and all India based recruitment in clerical and officers cadre as the policy of non-discrimination in employment opportunities. Thus the conceived framework of RRBs has been completely metamorphosed. On bank network front, the RRBs rose to 196 in number by 1991 and then started the phase of multiphase consolidation in 2005 bringing the number of RRBs to 43 as on 01-04-2020 through three rounds of amalgamations in the last fifteen years which has contextually changed the perception of the RRBs. All the core concepts have been bid farewell which were one district operation having changed to multi district and in some cases one RRB for one state, local staff recruitment has been taken over by all India recruitment in clerical and officers cadre and salary structures have been aligned with public sector banks coupled with pensionary benefits. No doubt these changes in RRB have been necessitated due the changing socio-economic and legal framework of the economy and society. These government initiatives are aimed at making the Regional Rural Banks big enough to survive at their own through scale and scope of economies. For effectively exploiting the synergies of scale and scope, some of the structural changes are also required, some of which are:

A- Level playing field should be ensured and RRBs must be aligned to changes of financial sector. RRBs are still on Basel I on capital provisioning perspective whereas industry is talking in terms of Basel 3.5 and 4. Reserve Bank of India (RBI) and National Bank for Agriculture and Rural Development (NABARD) must draw the clear road map for this imminent change, which will significantly increase the capital requirement of these RRBs.

B- Top management of the Bank (Chairman and General Managers) are from sponsor Banks. Time has come for market recruitment for the post of Chairman and elevation of General Manager from local RRB cadres. Though Assistant General Managers have been promoted in most of the RRBs but they are rarely posted as General Managers, which requires clear policy perspective on the issue. Sponsor Banks can exercise control through Board Nominated Directors. This will provide functional autonomy to RRBs.

D- IT infrastructure have to be improved though some south based banks have their robust IT systems but most of the RRBs are suffering on this count. Most of the RRBs are having sponsored bank managed Data Centres. This may

be aligned on the lines of Cooperative Banks where same system is being shared by cooperatives of the state which may be managed by NABARD and /or any other agency on sharing basis for all the RRBs across the country. Another alternative is compulsion on sponsor bank for simultaneous implementation of IT package in RRBs in line with sponsor Banks as most of the RRBs don't have mobile, internet or point of sale facilities even in this technology driven era, which are denting the business of RRBs against the much sought after government agenda of increasing digital payments.

- E- RRBs should be provided with repo and reverse repo facility which will improve their fund management and yield in a significant manner otherwise these RRBs are adopting fixed deposit route to manage their liquidity, which is costly in terms of revenue.
- E- RRBs are experiencing multiple controllers and regulators which must be rationalized.
- F- For operational purposed RRB may be classified as Small Finance Banks as there are significant gaps in regulatory communications on RRBs in absence of updated Master Circulars / Directions despite regular follow up by RRBs. This is all the more important in case of Regional Rural Banks where entire top management of the RRB is changed in three years on average, which is on deputation from sponsor bank.

The above policy initiatives may lead to strengthening of the RRBs in years to come from the managerial and business perspective.

## 2. Legislative and Administrative Issues

The restructuring and amalgamation exercise of the RRBs, which has happened during the last fifteen years, have been undertaken at the initiative of the Department of Financial Services, Ministry of Finance, Government of India in consultation with the State Governments and the Sponsor Banks. With present 43 RRBs after the current round of amalgamation, these banks may witness one more round of amalgamation for making these RRBs national in character by merging all RRBs of the same sponsored Bank in one single RRB, which will significantly reduce the number of RRBs further with increased operational area and make the RRBs bigger in size and economically viable. This change may require legislative approval as this will change the basis fabric of RRB Act. The second alternative is state wise merger of the RRBs with each state having one RRB which has already happened in some of the states to provide uniformity. The merger with sponsor Bank can also be thought of as the third alternate but it will trigger closer of various branches in the name of rationalization as has been experienced in the case of merger of public sector banks because of multiplicity of the branches at the same centre especially in rural and semi urban areas. This will have significant impact on the financial inclusion initiative of the government.

In this backdrop, let's analyze the projected profitability scenario for the Regional Rural Banks, which have significant stake in financial inclusion initiatives and agri and rural lending.

## Projected Financial Performance

RRBs are facing issues of operational efficiencies reflected in their poor financial ratios as presented in Table I. The net profit and loss of all the RRBs put together is loss of Rs 651.73 Crs as on 31-03-2019 which has increased to more than Rs2,200Crs during the year 2019-20 as per the provisional figure mainly because of provisions for pension liabilities. The situation on profitability front is likely to remain or may deteriorate due to unfunded pension liability which has to be fully provided for by 2022-23 at the rate of 20% on annual basis. The impending wage revision from 01-11-2017, which has recently been concluded with about 15% wage hike, will further add to the woes on the profitability front due to payment of arrears. Because of these losses, some of the RRBs have defaulted on their capital requirement leading to highly muted credit growth. The capital infusion provided to RRBs is on the retrospective balance sheet e.g. the Banks, which have defaulted on capital requirement as on 31-03-2020 will be given capital infusion only to the extent of minimum capital requirement as on 31-03-2020 during 2020-21 without any provision for growth capital. This impedes the business growth of the Banks. The thinning of margins is further adding to the pressures on profitability due to increasing competition from private banks, small finance banks, payment banks and even non-banking financial companies (NBFCs), which are expanding their operations in rural and semi-urban areas.

The poor financial ratios lead the banks to be classified as "Focus RRBs" and "PCA RRBs" by the supervisors thereby restraining them from concessional refinance and withdrawal of credit guarantee cover by credit guarantee institutions thereby further limiting their growth potential on the one hand increasing the capital requirement on the other in this phase of poor profitability.

The Capital Adequacy Ratio of all RRBs put together was at 11.40% as on 31-03-2019 against 12.40% as on 31-03-2018 mainly because of partial pension funding. Considering the impact of unfunded pension liability and impending wage settlement, the overall financial performance in terms of operating ratios is likely to deteriorate in foreseeable future of three to four years. To improve the financial performance of the Banks they require huge capital infusion not only for maintaining minimum capital requirement but also for growth capital.

Treasury Management is one of the areas where RRBs can manage their liquidity in a better manner. This requires extension of repo and reverse repo facilities to RRBs and their participation in domestic interbank lending and borrowing through money market operations. Presently RRBs are managing their liquidity through investment in Government Securities and interbank deposits. Exposure to money market operations will improve the profitability of the Banks and will significantly reduce their dependence on interbank deposits.

To conclude, it is high time for the organizational, operational and managerial restructuring of the RRBs, as these banks have gone through the structural reorganization in multiple phases. The synergies of structural reorganization can be harnessed through operational and managerial restructuring. The competition in rural financial landscape is continuously intensifying with increasing

expansion of lending and deposit taking non-banking financial companies, micro finance institutions, small finance banks and payment banks which has further fueled by increasing orientation of public and private sector banks towards rural lending due to focused attention of governments for rural development through doubling of farmers' income by 2022-23. Doubling of farmers' income is the major agenda of the present day government for bringing this marginalized section of the society to the mainstream of the economy, which will require significant credit

disbursement in rural areas and is possible only when bank have sufficient capital for supporting credit growth. Therefore it is high time to chart a clear road map for the Regional Rural Banks for their long term efficient contribution to the rural and agriculture sector of the economy in the national interest through their improved operational efficiency which in turn will translate in better profitability of the RRBs.

(The view expressed are personal view of the writer.)

