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# Profitability analysis of regional rural banks (RRBS) in India

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**Abstract**
The first regional rural banks in India were established in 1975. The foundation of Regional Rural Banks in India was conceptualised by the Narsimham committee. Regional rural banks (RRBs) are a one-of-a-kind experiment and experience in enhancing the efficiency of India's rural credit delivery system. In terms of geographic coverage, clientele outreach, and business volume, as well as contributing to the growth of the rural economy, they have played a vital role in rural institutional financing. Current study aims to check the profitability of R.R.Bs. of India. The study conducted is descriptive in nature and data is collected from published annual reports of RBI and NABARD for the period 2015-16 to 2020-21.

**Keywords:** R.R.Bs, profitability, return on assets, expenditure

## Introduction

India rural people such as small and marginal farmers, landless agricultural laborers, artisans and socially and economically backward castes and classes they have been exploited in the name of credit facility by informal sector. The rural credit market consists of both formal and informal financial institutions and agencies that meet the credit needs of the rural masses in India. The supply of total formal credit is inadequate and rural credit markets are imperfect and fragmented. Moreover, the distribution of formal sector credit has been unequal, particularly with respect to region and class, cast and gender in the country side. Regional Rural Banks were established under the provisions of an Ordinance promulgated on the 26th September1975 and the RRB Act, 1975 with an objective to ensure sufficient institutional credit for agriculture and other rural sectors. The RRBs mobilize financial resources from rural/semi-urban areas and grant loans and advances mostly to small and marginal farmers, agricultural laborers and rural artisans. For the purpose of classification of bank branches, the Reserve bank of India defines rural area as a place with a population of less than10, 000. RRBs are jointly owned by Government of India, the concerned State Government and Sponsor Banks; the issued capital of a RRB is shared by the owners in the proportion of 50%, 15% and 35% respectively.

## Review of Literature

Soni kumar Anil, Kapre Abhay (2012) examined the financial performance of RRBs in India from 2006-07 to 2010-2011. The current study is an extension of their previous work. They examined the performance of RRBs using various key performance indicators such as the number of banks, branches, loans, advances, and so on, and concluded that they had a positive impact on their performance.

Saveeta and Verma Sateesh (2001), Shravan Singh (2001), Kantawala Amita S (2004), Ketkar W Kusum et al. (2004), analyze the performance of banks from a profitability point of view, using various parameters. Most of the studies (Ganesan P 2001; Rayapati Vijayasree, 2002; Das M R, 2002-2003; and Gupta V & Jain P K, 2003) compared the performance of public, private and foreign banks by using measures of profitability, productivity, and financial management (Trehan Ruchi and Sonu Nitti, 2003).

Deshpande et al. (1999) studied the impact of deregulation of interest rates in turning the loss making RRBs to profit making institutions. A sample of 15 RRBs were taken for the study and the information was obtained for the period 1996-97. They found that impact of deregulation of interest rates on profitability was felt more strongly via advances (through increased interest cost) compared to decomposits (through increased interest income) compared deposits (through possible reduction in interest cost) and the combined impact on both advances and deposits on profitability was found to be limited.

Nitin and Thorat (2004) on a different note provide a penetrating analysis as to how constraints in the institutional dimensions have seriously impaired the governance of the RRBs. They have argued that perverse institutional arrangements that gave rise to incompatible incentive structures for key stakeholders such as political leaders, policy makers, bank staff and clients have acted as constraints on their performance. The lack luster performance of the RRBs during the last two decades, according to the authors can be largely attributed to their lack of commercial orientation.

Patel and Shete (1980) of the National Institute of Banking Management made a valuable analysis of performance and prospects of RRBs. They also gave a comparative picture of performance in deposits, branch expansion and credit deployment of the co-operative banks, commercial banks and RRBs in a specified area. This was an eye opener for many researchers engaged in this field of rural credit.

Kumar Raj (1993) carried out a study on the topic “Growth and Performance of RRBs in Haryana”. On the basis of the study of RRBs of Haryana, it is found that there was an enormous increase in deposits and outstanding advances. The researcher felt the need to increase the share capital and to ensure efficient us of distribution channels of finance to beneficiaries.

A. K. Jai Prakash (1996) 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.

**Objectives of study**

- To study the factor determining the profitability.
- To analyze the trend of profitability of regional rural banks.
- To find out the relationship between total expenditure and return on assets.

**Research Methodology and Data:** This study uses secondary data sources. All of the data needed to complete this study's objectives was gathered from the Reserve Bank of India's yearly reports on banking trends and progress in India. The data is for a six-year period commencing in 2015-16 and ending in 2020-21. The acquired data is organized into tables as needed in order to make useful judgments. Ratio analysis is used to conduct the study.

**Factor Determining the Profitability:**

Profit is defined as the difference between revenue and expenses. As a result, income and spending are the two primary pillars on which profitability is built, and they are described as follows:

**Income:**

The inflow of funds is considered as income for any financial institution. The banking income can be classified as follows:

Types of Bank Income

There are two broad sources of bank income or revenues. One is Interest Income or Fund Based Income and second is, Non-Interest Income or Non-fund Based Income.

**Interest Income/ Fund Based Income**

Short-term deposit investments, such as certificates of deposit with maturities of up to twelve months, savings accounts, and money market funds, are sometimes used by banks to save cash. The money in these accounts earns interest for the company, which is recorded as interest income on the income statement. It is a critical element of the business for others, such as insurance companies and financial institutions, who make money by investing the money they hold for policyholders in interest-paying bonds..

**Components of Interest/Fund Based Income**

Main components of Interest/ Fund Based Income are following.

1. **Income from Lending of Money**

In general, lending money refers to the act of giving away money or property with the hope of receiving the same item back. In other words, lending money is the transfer of securities to a borrower in exchange for a fee (typically so the borrower can pay back a short-term liability). The borrower commits to replace them with equivalent securities in a timely manner, and the lender assumes the risk/return of the assets in the meantime.

2. **Income from Investment (SLR)**

Every bank is expected to keep a minimum proportion of its net demand and time obligations as liquid assets in the form of cash gold and unencumbered approved securities at the end of each business day. The Statutory Liquidity Ratio is the proportion of liquid assets to demand and time liabilities (SLR). An increase in the SLR also limits the bank's leverage position, limiting its ability to inject more money into the economy.

**Non-Interest Income/Non-Fund Based Income**

In the face of declining net interest margins, depository institutions have entered new product areas over the past two decades, moving from traditional lending to Areas that generate Non-fund Based Income. The change is of importance for financial stability. The more unstable is a bank’s earnings stream, the more risky the institution is. The conventional wisdom in the banking industry is that earnings from fee-based products are more stable than loan-based earnings and those fee-based activities reduce bank risk via diversifications.

**Expenditure**

Expenditure is the collective outflow of funds from the institution. Banking expenditure is composed of:

**Interest expended**

The out flow of fund in the form of interest is known as the interest expended. It includes interest on deposits, interest on RBI borrowings, interest on interbank borrowings, penalties in case of non fulfillment of SLR and CRR requirements, etc. bank must strive towards low interest bearing deposits and go for low interest borrowings so that this expenditure is minimized. It must also comply with timely requirements of the CRR and SLR as required by the RBI so that funds do not slip in form of penalties. This expenditure forms the major part of the expenditure. Its increases will be the result of decreases the profitability.

**Operating expenses**

The operating expenses of bank includes salaries and wages of staff, rent, rates and taxes, printing and stationary, advertisement, depreciation of banks properties, directors fees, auditors fees, law charges, postage, repairs, insurance, etc. Bank must be conscious about the areas of increasing expenditures and a timely check over the cost-emitting factors is necessary to curb out the costs. At the present scenario where the banks are expanding, the expenses are going up. Banks must go through each and every activity producing cost.

**Provisions and contingencies**

This head of expenditure of banks include all provisions made for bad and doubtful debts, provisions for taxation, provisions for diminution in the value of investment, transfers to the contingencies, and other similar items.

**Analysis and Interpretation**

Profitability has been a subject of widespread concerns. As a result, it's important to figure out when policymakers and bankers should be concerned about the amount to which profit terms affect profitability.

The table -1.1 below gives present trends of operating profit, net profit, total expenditure and total income of R.R.B. for the financial year 2015-16 to 2020-21. The net profit for the year 2015-16 Rs. 2000 carore, 2016-17 Rs. 2300 carore, 2017-18 Rs. 1510, 2018-19 Rs. -548 2019-20 Rs. 1682, 2020-21 Rs. -2208. Where as in 2017-18 and 2018-19 decreases and just increases in 2019-20 but again decreases in further financial year. As far as expenditure is concerned, they have been lower than the income since 2015-16 to 2018-19. But in financial 2019-20the expenditure are more than the income. The S.D. 1779.69, mean 789.33 and Coefficient of variance is 225.47. The operating profit is also in increasing order that is Rs.2200 carore in 2015-16 to Rs. 7543 carore in 2017-18. The S.D. is 2431.43, mean is 5439.67 and C.V. is 44.70.

**Table 1:** Financial Performance of Regional Rural Banks (Amount in Rs. crore)

| Year | Total Income | Total Expenditure | Operating Profit | Net Profit | Total Assets |
|---|---|---|---|---|---|
| 2015-16 | 35400 | 33400 | 2200 | 2000 | 380800 |
| 2016-17 | 38800 | 36500 | 6000 | 2300 | 428800 |
| 2017-18 | 41819 | 40317 | 7543 | 1,510 | 476813 |
| 2018-19 | 43180 | 42893 | 5619 | -548 | 516263 |
| 2019-20 | 49452 | 51660 | 2,972 | 1,682 | 555660 |
| 2020-21 | 53858 | 52176 | 8,304 | -2208 | 617305 |
| Average | 43751.50 | 42824.33 | 5439.67 | 789.33 | 495940.17 |
| Standard Deviation | 6825.88 | 7754.09 | 2431.43 | 1779.69 | 85836.83 |
| C.V. | 15.60 | 18.11 | 44.70 | 225.47 | 17.31 |

Source- R.B.I., annual report on trends and progress of banking in India.

**Table 2:** Profitability ratios of Regional Rural Banks

| Year | Operating Profit Ratio (%) | Return on Assets Ratio (%) | Assets Utilisation Ratio (%) | Expenditure Ratio (%) | Profit Margin Ratio (%) |
|---|---|---|---|---|---|
| 2015-16 | 0.58 | 0.53 | 9.30 | 8.77 | 5.65 |
| 2016-17 | 1.40 | 0.54 | 9.05 | 8.51 | 5.93 |
| 2017-18 | 1.58 | 0.32 | 8.77 | 8.46 | 3.61 |
| 2018-19 | 1.09 | -0.11 | 8.36 | 8.31 | -1.27 |
| 2019-20 | 0.53 | 0.30 | 8.90 | 9.30 | 3.40 |
| 2020-21 | 1.35 | -0.36 | 8.72 | 8.45 | -4.10 |
| Average | 1.09 | 0.20 | 8.85 | 8.63 | 2.20 |
| Standard Deviation | 0.44 | 0.36 | 0.32 | 0.36 | 4.02 |
| C.V. (%) | 40.56 | 177.43 | 3.57 | 4.16 | 182.61 |

Source- compiled from Table-1.1

The consolidated operating profit ratio of R.R.Bs is not so good we can see the table 1.2 it shows that the highest operating profit is 1.58 percent of the total assets in 2017-18 and lowest operating profit is .53 percent of total assets in 2019-20. The S.D. is 0.44, mean is 1.09 and C.V. is 40.56. We can say after seeing the chart-1that the operating profit ratio is fluctuating overall the study period.

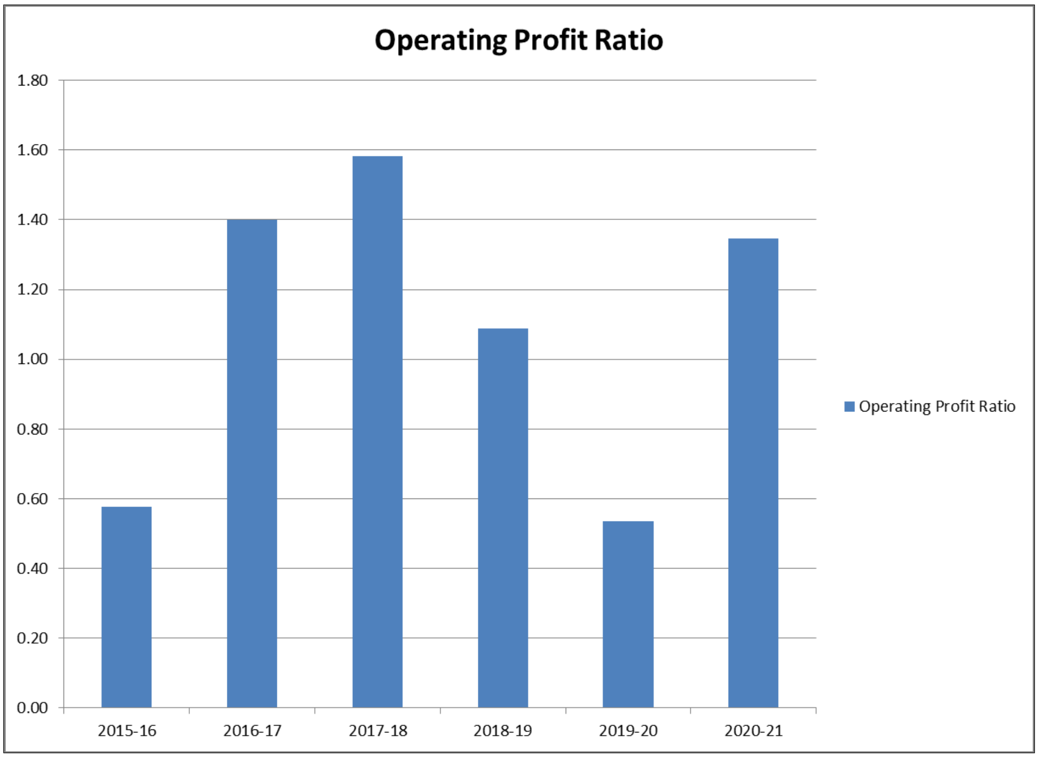


**Fig 1**

The table 1.2 also shows that return on assets in 2015-16 is .53 and in 2016-17 is 0.54. the highest rate of return on assets is 054 in 2016-17 and lowest rate of return on assets is -.11 in 2018-19 and -.36 in 2020-21. We can say after seeing the chart-2 that the return on assets ratio is fluctuating overall the study period and it's not good indication for the bank.

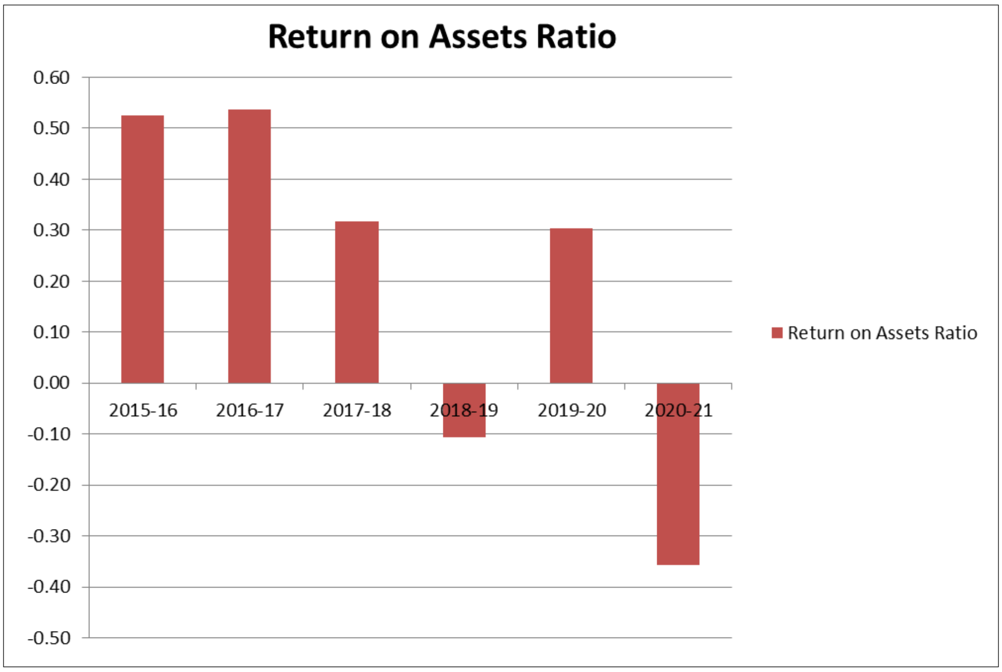


**Fig 2**

The S.D. is 0.36, mean is 0.20 and C.V. is 177.43. We have also found the negative correlation (-0.48) between total expenditure and return on assets.

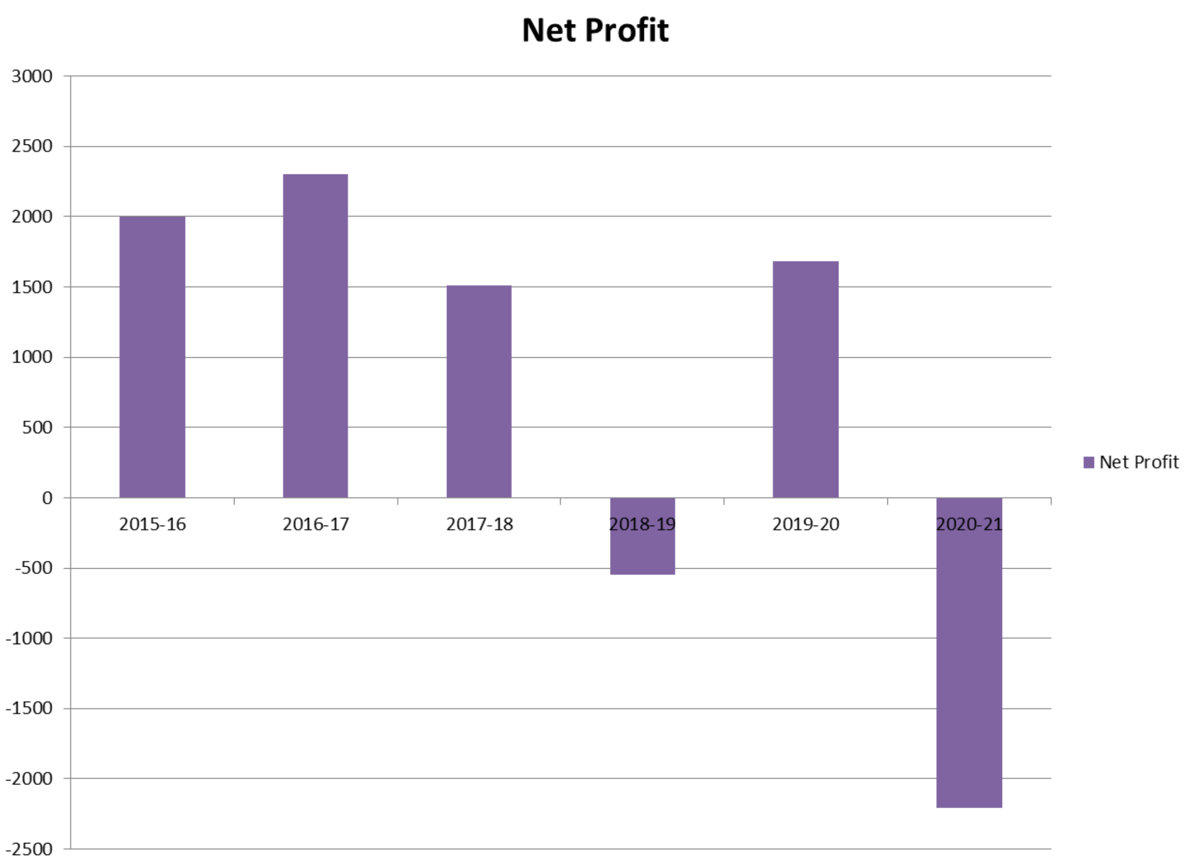


**Fig 3**

After looking at chart-3, we can see that the net profit improves only in the financial year 2016-17, then declines in 2017-18, then decreases and goes negative in 2018-19, while increasing in 2019-20 and then becoming negative again.

## Findings and Suggestions

Since the financial sector reforms of 1991, there have been significant favorable change in banking sector. Thus the profitability of banking sector in India has been becoming a subject matter of discussion. The analysis of profitability of Regional Rural Banks shows clearly low profitability during the study period. The result of table 1.1 and 1.2 with charts indicate that the profitability of R.R.Bs. turned to upward only in 2016-17 but after it's declined continuously. Here we find that negative relationship with total expenditure and return on assets (-0.48) that may be an affecting factor for low profitability. So that it is required to engaging in non -traditional activities, cost and efficiency management of whole banking system.

RRBs must make significant changes in their investment decision-making. The RRBs must exercise extreme caution and decrease operating expenses, as our research has revealed that these costs have increased the banks' total spending. The government should take serious action against defaulters rather than making popular announcements such as loan forgiveness. Controlling costs and raising revenue are two ways to boost productivity

## Conclusion

To conclusion, the rapid expansion of RRB has contributed to a significant reduction in regional differences in banking services in India. RRB's efforts in deposit mobilisation, rural development, branch expansion, and credit deployment in rural areas' weaker sections are commendable. RRB has succeeded in achieving its goals of bringing banking to rural households' doorsteps, particularly in banking-deprived rural areas, providing easy and affordable credit to rural households who are reliant on private lenders, encouraging rural savings for productive activities, creating jobs in rural areas, and lowering the cost of providing credit in rural areas. As a result, RRB has the most extensive banking network. The government should take some effective corrective measures.

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