PERFORMANCE EVALUATION OF REGIONAL RURAL BANKS WITH REFERENCE TO TELANGANA GRAMINA BANK, HYDERABAD

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ABSTRACT
The Banks have been in existence for around three decades in the Indian financial scenario. Inception of regional rural banks (RRBs) can be seen as a unique experiment as well as experience in improving the efficiency of rural credit delivery mechanism in India. With joint shareholding by Central Government, the concerned State Government and the sponsoring bank, an effort was made to integrate commercial banking within the broad policy thrust towards social banking keeping in view the local peculiarities. The genesis of the RRBs can be traced to the need for a stronger institutional arrangement for providing rural credit. Their equity is held by the Central Government, concerned State Government and the Sponsor Bank in the proportion of 50:15:35. RRBs were supposed to evolve as specialized rural financial institutions for developing the rural economy by providing credit to small and marginal farmers, agricultural laborers, artisans and small entrepreneurs. The study is diagnostic and exploratory in nature, and makes use of secondary data. The study found that the performance of Telangana Gramenna Bank in Hyderabad branches has significantly improved over time, as steps for their improvement were initiated by the Government of India after the amalgamation process.
Keywords: *Performance, RBI, Priority Sector, Advances, Rural Credit, NPA, Key Performance Indicators, Regional Rural Banks.*

INTRODUCTION:
Regional Rural Banks have been in existence for around 32 years in the Indian financial scene. Inception of Regional Rural Banks may be seen as a unique experiment as well as experience in improving the efficacy of rural credit delivery mechanism in India. Keeping in view the local peculiarities, an effort was made to integrate commercial banking within the broad policy framework towards social banking through joint shareholding of Central Government, the Concerned State Governments and the Sponsoring Bank. The genesis of the Regional Rural Banks may be traced for the need for a stronger institutional arrangement for providing rural credit. The institution of Regional Rural Banks (RRBs) was created to meet the excess demand for institutional credit in the rural areas, particularly among the economically and socially marginalized sections. Although the cooperative banks and the commercial banks had reasonable records in terms of geographical coverage and disbursement of credit, in terms of population groups the cooperative banks were dominated by the rural rich, while the commercial banks had a clear urban bias. The Banking Commission (1972) recommended to establish an alternative institution for rural credit and ultimately Government of India established Regional Rural Banks – a separate institution basically for rural credit on the basis of the recommendations of the Working Group under the Chairmanship of Sh. M. Narashimham. In order to provide access to low-cost banking facilities to the poor, the Narashimham Working Group (1975) proposed the

establishment of a new set of banks, 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". Subsequently, the Regional Rural Banks were setup through the promulgation of RRB Act of 1976. The RRBs Act, 1976 succinctly sums up this overall vision to sub-serve both the developmental and the redistributive objectives. The RRBs were established "with a view to developing the rural economy by providing, for the purpose of development of agriculture, trade, commerce, industry and other productive activities in the rural areas, credit and other facilities, particularly to small and marginal farmers, agricultural laborers, artisans and small entrepreneurs, and for matters connected therewith and incidental thereto". Regional Rural Banks were supposed to evolve as specialized rural financial institutions for developing the rural economy by providing credit to small and marginal farmers, agricultural laborers, artisans and small entrepreneurs. Their equity is held by the Central Government, Concerned State Government and the Sponsor Bank in the proportion of 50:15:35 respectively.

The mandates of these rural financial institutions were to:
(a) Take banking to the doorsteps of the rural masses, particularly in areas without banking facilities;
(b) Make available cheaper institutional credit to the weaker sections of society, who were to be the only clients of these banks;
(c) Mobilize rural savings and canalize them for supporting productive activities in the rural areas;
(d) Generate employment opportunities in the rural areas and
(e) Bring down the cost of providing credit in rural areas

REVIEW OF LITERATURE

RRBs though operate with a rural focus are primarily scheduled commercial banks with a commercial orientation. Beginning with the seminal contribution of Haslem (1968), the literature probing into factors influencing performance of banks recognises two broad sets of factors, i.e., internal factors and factors external to the bank. The internal determinants originate from the balance sheets and/or profit and loss accounts of the bank concerned and are often termed as micro or bank-specific determinants of profitability. The external determinants are systemic forces that reflect the economic environment which conditions the operation and performance of financial institutions. A number of explanatory variables have been suggested in the literature for both the internal and external determinants. The typical internal determinants employed are variables, such as, size and capital [Akhavein et al. (1997), Demirguc-Kunt and Maksimovic (1998) Short (1979) Haslem (1968), Short (1979), Bourke (1989), Molyneux and Thornton (1992) Bikker and Hu (2002) and Goddard et al. (2004)]. Given the nature of banking business, the need for risk management is of crucial importance for a bank's financial health. Risk management is a reflection of the quality of the assets with a bank and availability of liquidity

with it. During periods of uncertainty and economic slow down, banks may prefer a more diversified portfolio to avoid adverse selection and may also raise their liquid holdings in order to reduce risk. In this context, both credit and liquidity risk assume importance. The literature provides mixed evidence on the impact of liquidity on profitability. While Molyneux and Thornton (1992) found a negative and significant relationship between the level of liquidity and profitability, Bourke (1989) in contrast, reports an opposite result. One possible reason for the conflicting findings may be the different elasticity of demand for loans in the samples used in the studies (Guru, Staunton and Balashanmugam, 2004). Credit risk is found to have a negative impact on profitability (Miller and Noulas, 1997). This result may be explained by taking into account the fact that more the financial institutions are exposed to high-risk loans, the higher is the accumulation of unpaid loans implying that these loan losses have produced lower returns to many commercial banks (Athanasoglou, Brissimis and Delis, 2005). Some of the other internal determinants found in the literature are funds source management and funds use management (Haslam, 1968), capital and liquidity ratios, the credit-deposit ratio and loan loss expenses [Short (1979); Bell and Murphy (1969); Kwast and Rose (1982)]. Expense management, a correlate of efficient management is another very important determinant of bank's profitability. There has been an extensive literature based on the idea that an expenses-related variable should be included in the cost part of a standard microeconomic profit function. In this context, Bourke (1989) and Molyneux and Thornton (1992) find that better-quality management and profitability go hand in hand. As far as the external determinants of bank profitability are concerned the literature distinguishes between control variables that describe the macroeconomic environment, such as inflation, interest rates and cyclical output, and variables that represent market characteristics. The latter refer to market concentration, industry size and ownership status. Among the external determinants which are empirically modeled are regulation [Jordan (1972); Edwards (1977); Tucillo (1973)], bank size and economies of scale [Benston, Hanweck and Humphrey (1982); Short (1979)], competition [Phillips (1964); Tschoegl (!982)], concentration [Rhoades (1977); Schuster (1984)], growth in market [Short (1979)], interest rates as a proxy for capital scarcity and government ownership (Short, 1979). The most frequently used macroeconomic control variables are the inflation rate, the long-term interest rate and/or the growth rate of money supply. Revell (1979) introduced the issue of the relationship between bank profitability and inflation. He notes that the effect of inflation on bank profitability depends on whether banks' wages and other operating expenses increase at a faster pace than inflation. Perry (1992) in a similar vein contends that the extent to which inflation affects bank profitability depends on whether inflation expectations are fully anticipated. The influence arising from ownership status of a bank on its profitability is another much debated and frequently visited issue in the literature. The proposition that privately owned institutions are more profitable, however, has mixed empirical evidence in favour of it. For instance, while Short (1979) provides cross-country evidence of a strong negative relationship between government ownership and bank profitability, Barth et al. (2004) claim that government ownership of banks is indeed negatively correlated with bank efficiency. Furthermore, Bourke (1989) and Molyneux

and Thornton (1992) find ownership status is irrelevant in explaining profitability. While many of the above factors would be relevant, it would be instructive to scan the literature that has exclusively focused on the RRBs.

Performance of RRBs in the Spatial Dimension: Some Stylized Facts

The RRBs, over the years have made impressive strides on various business indicators. For instance, deposits of RRBs have grown by 18 times and advances by 13 times between 1980 and 1990. Between 1990 and 2004, deposits and advances grew by 14 times and 7 times, respectively (Table 1). Between the year 2000 and 2004, loans disbursed by RRBs more than doubled reflecting the efforts taken by the banks6 to improve credit flow to the rural sector. The average per branch advances also increased from Rs.25 lakh in March 1990 to Rs.154 lakh in March 2003. When one considers the deployment of credit relative to the mobilisation of resources, the credit-deposit (C-D) ratio of RRBs were more than 100 per cent during the first decade of their operations up to 1987. Though the C-D ratio subsequently became lower, of late, it has shown an improvement and went up from around 39 per cent in March 2000 to 44.5 per cent in March 2004.

Table 1: Evolution of RRBs: Select Indicators

(Rs. Crore)

Parameter	1980	1985	1990	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
No. of RRBs	85	188	196	196	196	196	196	196	196	196	196	196	196
Capital	21	46	91	166	358	705	1,118	1,380	1,959	2,049	2,143	2,141	2,221
Deposits	222	1,315	4,023	11,141	14,171	17,976	22,191	27,059	32,226	38,294	44,539	49,582	56,295
Investments	20	164	60	1,348	2,879	3,891	5,280	6,680	7,760	8,800	9,471	17,138	21,286
Advances	262	1,405	3,384	5,987	7,057	7,908	9,021	10,559	12,427	15,050	17,710	20,934	25,038
Total Assets	426	2,320	6,081	14,886	18,969	24,376	29,468	35,820	42,236	49,596	56,802	62,500	70,195
Interest Earned	NA	NA	480	1,158	1,421	2,033	2,624	3,281	3,938	4,619	5,191	5,391	5,535
Other income	NA	NA	113	72	89	103	136	151	207	240	370	430	697
Total Income	NA	NA	593	1,230	1,511	2,136	2,760	3,432	4,145	4,859	5,561	5,821	6,231
Interest expended	NA	NA	326	851	1,065	1,462	1,773	2,131	2,565	2,966	3,329	3,440	3,363
Operating expenses	NA	NA	254	657	726	804	845	982	1,056	1,165	1,459	1,667	1,825
Provisions and contingencies	NA	NA	NA	120	171	673	72	99	96	128	163	132	289
Total expenses	NA	NA	581	1,509	1,791	2,265	2,617	3,113	3,621	4,130	4,787	5,107	5,187
Operating Profit	NA	NA	12	-279	-280	-129	143	319	524	729	774	714	1,044

Note : Total expenses are excluding provisions and contingencies.
Source : Reserve Bank of India.

OBJECTIVES OF RESEARCH

1) To measure Financial Performance of Regional Rural banks in Telangana State.

2) To Evaluate Progress of the Telangana Gramenna Banks in Telangana Bank.
3) To make important Suggestions to improve the Working Performance of Telangana Gramenna Bank.

Data and Methodology

Net income as a percentage to total assets (NITA)8 is taken to be the indicator of financial performance of the RRBs. NITA measures how profitably and efficiently the RRB is making use of its total assets. Deflating the net income by total assets also takes account of the variation in the absolute magnitude of the profits, which may be size related. The performance of RRBs is postulated to depend upon two broad sets of factors, internal to the RRBs as well as external to them. The internal factors are represented through the balance sheet information of the individual RRBs. RRBs are scheduled commercial banks whose source of income arises primarily from lending and investment. Balance sheet management on part of RRBs requires a judicious mix between lending and investment. As such, loans and advances of each RRB as a percentage of total assets (LOTA) and investments in securities of each RRB as a percentage of total assets (INTA) are included as explanatory variables. In terms of liquidity management, since banks are involved in the business of transforming short-term deposits into long-term credit, they would be constantly faced with the risks associated with the maturity mismatch. In order to hedge against liquidity deficits, which can lead to insolvency problems, banks often hold liquid assets, which can be easily converted to cash. However, liquid assets are often associated with lower rates of return. Hence, high liquidity is expected to be associated with lower profitability (Molyneux and Thornton, 1992). The impact of liquidity on profitability is captured through the variable LIQ, which is represented through Cash in Hand of the RRBs as a proportion of their Assets. Another internal factor that can be expected to have a significant effect on the financial health of the RRBs is their efficiency in expense management. The 'total expenses' shown in profit & loss account of the RRBs is the sum of 'interest expenses' and 'operating expenses'. While rising operating costs to support increasing business activities is natural, increasing operating costs relative to non operating expenses is a matter of concern and reflects poor expense management. To judge the impact of expense management on balance sheet health, the variable operating expenses as a percentage of total expenditure (OE) has been taken as another independent variable.

Apart from the internal factors, the literature recognises the influence of the sponsor bank on a RRB's health through what is termed as the umbilical cord (Malhotra, 2002). According to the umbilical cord hypothesis, given the very close relationship9 between the RRB and its sponsor bank, the attitude of the sponsor bank would have a bearing on the performance of the RRB. As it is quite complex to quantify the attitude of the sponsor bank towards the concerned RRB, the impact of the sponsor bank has been subsumed under a single indicator and it is the financial health of the sponsor bank. Financial health of the sponsor bank reflected through its net income as a percentage of its total assets (NITASPON) has been included as one of the regressors. Based on the above discussion, to ascertain the impact of the internal and the external factors on bank

profitability, panel data regression models have been used. Equation (1) describes the general specification of the model. Equation (1) can be estimated either by least squares or through a procedure that accounts for fixed/ random effects.

$$NITA_{i,t} = \eta_1 LOTA_{i,t} + \eta_2 INTA_{i,t} + \eta_3 LIQ_{i,t} + \eta_4 OE_{i,t} + \eta_5 NITASPON_{i,t} + \varepsilon_{i,t} \quad (1)$$

Where,

$\eta_1, \eta_2, \eta_3, \eta_4,$ and η_5 are parameters to be estimated.

NITA=Net Income to Assets

LOTA = Loan as a proportion of Total Assets.

INTA =Investment as a proportion of Total assets.

LIQ=Cash in Hand as a proportion of Total Assets

OE= Operating Expenses as a proportion of Total Expenditure

NITASPON= Net Income to Assets of the Sponsor Bank.

$\varepsilon_{i,t}$= Error Term

The subscripts i and t refer to the year and cross section (RRB); respectively. In addition to the above factors, an environmental factor that may affect both the costs and revenue of the RRBs is the inflationary conditions in the economy. The impact of inflation rates on bank profitability depends on its effect on a bank's costs and revenues. The effect of inflation on bank performance depends on whether the inflation is anticipated or unanticipated (Perry, 1992). If inflation is fully anticipated and interest rates are adjusted accordingly resulting in revenues rising faster than costs, then it would have a positive impact on profitability. However, if the inflation is not anticipated and the banks are sluggish in adjusting their interest rates then there is a possibility that bank costs may increase faster than bank revenues and hence, adversely affect bank profitability. Interest rates in India were administered for a long time till the onset of financial liberalization. In the post liberalisation phase though banks have greater freedom to price their products, maneuverability on part of banks in adjusting the interest rates are rather limited on account of the preference for fixed rate deposits, administered savings, etc. Furthermore, as all the variables in (1) are expressed as ratios, inflation is already accounted for in the model. Hence, inflation as an additional variable has been excluded from the regression model. It is quite possible that past year's performance has a bearing on today's performance and non-incorporation of the same in the econometric estimation would blur the impact of other variables on NITA. To account for the past year's performance, lagged value of NITA has also been considered in an extended model. The extended model assumes specification as laid down in equation (2).

$$NITA_{i,t} = \eta_0 NITA_{i,t-1} + \eta_1 LOTA_{i,t} + \eta_2 INTA_{i,t} + \eta_3 LIQ_{i,t} + \eta_4 OE_{i,t} + \eta_5 NITASPON_{i,t} + \varepsilon_{i,t} \quad (2)$$

Where, **η** s are the parameters to be estimated. The extended model (2) is a dynamic panel data model. A dynamic panel model poses a number of econometric issues. The major problem that arises when lagged dependent variable is introduced as an explanatory variable is that the error term and the lagged dependent variable are correlated, with the lagged dependent variable being correlated with the individual specific effects that are subsumed into the error term. This implies that standard estimators are biased, and as such an alternative method of estimating such models is required. The standard procedure to provide consistent estimates is to adopt an instrumental variable procedure, with different lags of the dependent variable used as instruments. Although a number of candidates are possible, the Arellano and Bover (1995) approach is adopted as this generates the most efficient estimates. While using lagged dependent variables as instruments, overall instrument validity is examined using a Sargan test of over identifying restrictions.

The study covers the period 1994-2003. The choice of end points for the period of analysis is essentially governed by two considerations. Based on the recommendations of the Narasimham Committee Report (1992), reforms were initiated in 1993 to turn around the failing RRBs. To enhance financial viability, a new set of prudential accounting norms of income recognition, asset classification, provisioning, and capital adequacy were implemented. Banks were also required to make full provisioning for bulk of their non-performing assets. Furthermore, they were permitted to lend to non-target group borrowers up to 60 per cent of new loans beginning in 1993-94. Permission was also granted to introduce new services, such as loans for consumer durables. As such, year 1993-94 has been taken as the initial year for estimation when the RRBs were given the opportunity to operate in a more liberal framework. The choice of the terminal year for the empirical study is guided by the availability of balance sheet information on both RRBs as well as the sponsor bank from the various issues of Statistical Tables Relating to Banks in India brought out by the Reserve Bank of India. Balance sheet information was available till 2002-03 for RRBs when the study was carried out. The study deals with all the 196 RRBs except one[10] . To get a deeper insight into the factors contributing to the financial performance of RRBs, the empirical analysis has been carried out separately for the profit and the loss making RRBs apart from for all the RRBs taken together. Those RRBs that earned profits consecutively for three years during 2000-01 till 2002-03 have been categorized as the profit making RRBs and the rest as loss making RRBs.

BANKS PERFORMANCE AT A GLANCE 2015-16

HIGHLIGHTS		**(₹ in Crore)**
	31st March 2016	**31st March 2015**
Branches	363	330
Deposits	5836.95	4890.33

Advances	4560.27	4162.54
Total Business	10397.22	9052.87
Gross Profit	102.49	167.29
Gross NPAs	105.45	88.91
Gross NPA to Aggregate Advances	2.31%	2.14%
Net NPA to Aggregate Advances	0.97%	0.64%
Average Cost of Deposit	7.52%	7.58%
Average Yield on Advances	10.71%	12.49%
Average Return on Investments	8.08%	90.%
Advances to Priority Sector	78.07%	65.86%
Credit Deposit Ratio	78.13%	85.12%
Owned Funds	553.61	484.39
Productivity		
a) per branch	28.64	27.43
b) per branch	7.16	6.59

CONCLUSION

Regional Rural Banks (RRBs), emerged as an important Financial Institution in India for meeting the Rural Credit Requirement. It is always argued that the RRBs have not been able to earn much profit in view of their Policy of Restrictions over their operations to Target Groups. In spite of that, the RRBs have made a Remarkable Performance. To conclude, the Rapid Expansion of RRB has helped in reducing substantially the regional disparities in respect of banking facilities in India. The efforts made by RRB in its branch expansion, deposit mobilization, rural development and credit deployment to weaker section of rural areas are appreciable. RRB successfully achieve its objectives by taking banking to door steps of rural households particularly in banking deprived rural areas, 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. So, in the light of these lines, this Research paper concludes that the Performance of Telangana Gramina Bank in meeting its objectives is successful and appreciable based on the available data for the purpose of study. And the paper conveys a message to the Government to take additional needful support to these Regional Rural Banks to make them more viable and successful in meeting the needs of rural credit in the coming years.

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