A Study on Merger Impacts of Regional Rural Banks in India

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Banks play an important role in mobilization and allocation of resources in our country. Rural people in India are still facing problems for inadequate supply of credit. RRBs were established in India in 1975 essentially for the purpose of taking banking service to the thresholds of rural people, particularly in places lacking banking facilities. Reforms and mergers introduced by the Government of India in consultation with Reserve Bank of India (RBI) and National Bank for Agriculture and Rural Development (NABARD) in the years 1994-95 to 2005-06 have yielded positive results in respect of key performance indicators such as number of branches, district coverage, deposits mobilized, credits and investments made by the Indian Regional Rural Banks (RRBs). The objective of this paper is to investigate whether the merger/amalgamation of Regional Rural Banks in India, undertaken during 2008-09 to 2012-13 has helped improve their performance. Several committees have emphasized the need to improve the performance of these banks which play an important role in the rural credit market in India. The study is analytical in nature and makes use of secondary data. The study finds and concludes that performance of rural banks in India has significantly improved after amalgamation process which has been initiated by the Government of India.

Keywords: Regional Rural Bank, Pre-Merger, Post-Merger, Owned Funds, Borrowed Funds.

1. Introduction

Regional Rural Banks were established in India in 1975 essentially for the purpose of taking banking service to the thresholds of rural people, particularly in places lacking banking facilities. Banks play an important role in mobilization and allocation of resources in our country. Rural people in India are still facing problems for inadequate supply of credit. The major source of credit to rural business people, households, particularly-low income working households, has been made possible by rural banks. In 1982, to consolidate the various arrangements made by the RBI to promote and supervise institutions and channel credit to rural areas, the National Bank for Agricultural and Rural Development (NABARD) was established. Informal sector advances loans at very high rates of interest; the terms and conditions attached to such loans have given rise to an elaborate structure of intimidation of both economic and non-economic conditions in rural population in India.

Several changes have taken place in the focus and operation of the Regional Rural Banks in the wake of financial sector reforms in India and various measures have been taken by the Government to improve the commercial viability of RRB since 1994-95. So it has been considered appropriate to study the performance after amalgamation which started to took place in the year 2006.A study of the efficiency and its performance of the RRB are particularly important in the Indian context. The goals as given in the preamble of RRB Act of 1976 were "to develop the rural economy in 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 the small and marginal farmers, agricultural laborer's, artisans and small entrepreneurs and for matter connected therewith and incidental thereto". The objective of this study is to analyze the performance of RRBs during pre and post-merger periods. The indicators selected to study the performance of the RRBs such as number of branches, district coverage, deposits mobilized, credits and investments made by the Indian Regional Rural Banks (RRBs).

2. An Overview of Indian Regional Rural Banks (RRB)

Regional Rural Banks were established under the provisions of an Ordinance promulgated on the 26th September 1975 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 and 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 than 10,000. 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. The first five RRBs were set up in five States in Haryana, West Bengal, Rajasthan, with one each and two in Uttar Pradesh, which were sponsored by different commercial banks. These banks covered 11 districts of these five states.

The first five Regional Rural Banks are as follows;

- Prathama Bank and Gorakhpur Kshetriya Gramin Bank in Uttar Pradesh,
- Haryana Krishi Gramin Bank in Haryana,
- Gour Gramin Bank in West Bengal,
- Jaipur-Nagpur Anchalik Gramin Bank, Rajasthan.

In India rural people those are socially and economically backward 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.

The rationale for establishment of the RRB was to mobilize deposits, access to central money market and modernized outlook, which the commercial banks have. Sound financial position is essential for any organization to survive to render the services to the society. RRBs are expected to mobilize resources from rural areas and play a significant role in developing agriculture and rural economy by deploying mobilized resources in rural sectors for the needy not conversed by other formal credit institutions.

Objectives of the Study

- To study the growth and performance of RRB in India.
- To assess the financial measures during pre-merger and post-merger of RRB.
- To analyze the source of capital in terms of borrowed funds and owned funds of RRB.

3. Merger Process and Reforms

To strengthen RRBs and improve their performance many initiatives have been taken by the Government of India and the Reserve Bank of India (RBI). The comprehensive restructuring program, recapitalization of RRBs was initiated in the year 1994-95. The process continued till 1990-2000 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. In the wake of introduction of financial sector reforms in 1991-92, the commercial viability of RRBs emerged as the most critical factor in deciding about their desired role due to their limited business flexibility with scope of expansion/diversification, smaller size of loans with higher risk and professional efficiency in financial deployment.

Further, the branch licensing policy for RRBs has been liberalized. The regional offices of RBI clear RRB application to open new branches under the new norms empowered committees. 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 permitted 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 distant 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.

In 2005-06, the Government of India initiated the process of structural consolidation of RRBs by amalgamating RRBs sponsored by the same bank within a State as per the recommendations of the *Vyas Committee (2004).* The amalgamated RRBs were expected to provide better customer service due to better infrastructure, computerization of branches, pooling of experienced work force, common publicity, marketing efforts etc., and also derive the benefits of a large area of operation, enhanced credit exposure limits and more diverse banking activities. As a result of the amalgamation, the number of RRBs was reduced considerably during the year 2009. Thus, under the amalgamation process, 145 RRBs have been amalgamated to form 45 new RRBs.

4. Review of Literature

Syed Ibrahim (2010) has analyzed the performance of regional rural banks in India with various parameters pertaining to RRB. Professor Dilip Khankhoje and Dr. Milind Sathye (2008) have analyzed to measure the variation in the performance in terms of productive efficiency of RRBs in India and to assess if the efficiency of these institutions has increased post-restructuring in 1993-94. Chavan and Pallavi (2004) have examined the growth and regional distribution of rural banking over the period 1975-2002. According to Nathan, Swami (2002), policies of current phase of financial liberalization have had an immediate, direct and dramatic effect on rural credit. L.K Naidu (1998) conducted a study on RRBs taking a sample of 48 beneficiaries of rural artisans in Cuddapah district of Andhra Pradesh state under Rayale Seen Gramin Bank. 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. Kumar Raj (1993) carried out a study on the topic “Growth and Performance of RRBs in Haryana”. Kalkundrickars (1990) in his study on “Performance and Growth of regional Rural Banks in Karnataka” found that these banks had benefited the beneficiaries in raising their income, productivity, employment and use of modern practices and rehabilitate rural artisans. NABARD

(1986) published “A study on RRBs viability”, which was conducted by Agriculture Finance Corporation in 1986 on behalf of NABARD. Patel and Shete (1980) of the National Institute of Banking Management made a valuable analysis of performance and prospects of RRBs.

5. Research Methodology

This study is analytical in nature and makes use of secondary data. The relevant secondary data have been collected mainly through the data bases of Reserve Bank of India (RBI), National Bank for Agricultural and Rural Development (NABARD). The journals like the Journal of Indian Institute of Bankers have also been referred. The study is confined only to the specific areas like number of branches, district coverage, deposits mobilized, credits and investments made by the Indian Regional Rural Banks (RRBs) for the five years period starting from 2008-09 to the year 2012-13. In order to analyze the data and draw conclusions statistical tools like‘t’ test and ANOVA have been accomplished.

6. Analysis and Findings

Growth of RRB

The number of RRBs decreased from 196 in the year 2008-09 to 86 in 2012-13. This was due to the amalgamation that took place in the year 2010-11, covering 525 districts with a network of 14,494 branches. However, the number of branches has been significantly increased from 14,446 in 2008-09 to 15,181 in 2012-13. The increase over the period was around 5.08%. Regional Rural Banks in India have achieved tremendous growth in terms of number of banks and its wide braches which is shown in the Table-1.

Table 1 *Growth of Regional Rural Banks in India*

Years	Number of RRBs	Number of Branches
2008-09	196	14,446
2009-10	133	14,484
2010-11	94	14,494
2011-12	90	14,761
2012-13	86	15,181

Source *NABARD*

Post-Merger and Pre-Merger Performance of RRB (in respect of growth): Till the birth of RRBs in India, Commercial Banks and Co-operative Banks were rendered services to the rural public. But despite such large network of bank branches, the credit needs of the rural population in India were quite inadequate. A paired t-test was performed to determine whether the pre-merger period performance significantly differs from the post-merger period performance of the Regional Rural Banks in India. The test results are furnished in Table-2.

H_o: There is no significant difference in performance between the pre-merger period and post- merger period.
H_1: There is significant difference in performance between the pre-merger period and post- merger period.

Table-2 ‘t’-*Test results-Number of Branches of RRBs*

	Post-Merger	Pre-Merger
Mean	14739	14438.25
Variance	101278	1502.917
Observations	4	4
Pearson Correlation	0.901403	
Hypothesized Mean Difference	0	
df	3	
t Stat	2.119497	
P(T<=t) one-tail	0.062121	
t Critical one-tail	2.353363	
P(T<=t) two-tail	0.124242	
t Critical two-tail	3.182446	

Since the calculated value (3.182446) is greater than the table value (0.124242), null hypothesis is rejected. Hence there is significant difference between pre-merger and post-merger performance in respect of number of branches of the RRB.

Capital Composition

RRBs have both types of capital i.e., owned and borrowed. Both the owned funds and borrowed funds have constantly been increased over the period of study. Table-3 reveals that the year-wise components of total capital comprises of owned funds and borrowed funds of RRBs in India. It is important to observe from the table that the borrowed funds constitute more percentage than the owned funds during the post-merger period especially the year 2010-11 and increased more than the previous year's 2008-09 and 2009-10.

Table 3 *Components of Total Capital Funds (Rs in crore)*

Years	Owned Funds	% to Total Funds	Borrowed Funds	% to Total Funds	Total Funds
2008-09	6,181	52.80	5,524	47.20	11,705 (100%)
2009-10	6,647	47.65	7,303	52.35	13,950 (100%)
2010-11	7,286	42.70	9,776	57.30	17,062 (100%)
2011-12	8,733	43.17	11,494	56.83	20,227 (100%)
2012-13	10,910	46.14	12,736	53.86	23,646 (100%)

Source *Central Statistical Information Department, NABARD*

Post-Merger and Pre-Merger Performance of RRB (in respect of total funds): A paired t-test was performed to determine whether the pre-merger period performance significantly differs from the post-merger period performance in the terms of total funds of the Regional Rural Banks in India.

Ho: There is no significant difference in performance between the pre-merger period and post- merger period.
H_1: There is significant difference in performance between the pre-merger periodand post- merger period.

Table 4 *'t'-Test results-Total Funds of RRB*

	Post-Merger	Pre-Merger
Mean	10401	20311.67
Variance	1355968	10842640
Observations	3	3
Pearson Correlation	0.967675	
Hypothesized Mean Difference	0	
df	2	
t Stat	-7.85326	
P(T<=t) one-tail	0.007915	
t Critical one-tail	2.919986	
P(T<=t) two-tail	0.01583	
t Critical two-tail	4.302653	

Since the calculated value (4.302653) is greater than the table value (0.01583), null hypothesis is not accepted. Hence there is significant difference between pre-merger and post-merger performance in terms of total funds of the RRB.

Performance Comparison of Owned Funds and Borrowed Funds of RRB: The performance of the owned funds and borrowed funds of the RRBs were compared using ANOVA to test whether the merger process has resulted in improving the performance in terms of the owned funds and borrowed funds of these banks in India during the study period. The test results are given in Table-5.

Ho: There is no significant difference in performance between owned funds and borrowed funds.
H_1: There is significant difference in performance between owned funds and borrowed funds.

Table 5 ANOVA *(Single Factor) (Owned Funds and Borrowed Funds)*
Summary

Groups	Count	Sum	Average	Variance
Owned Funds	5	53920	6740	5023519
Borrowed Funds	5	60751	7594	11001685

ANOVA

Source of Variation	SS	df	MS	F	P-Value	F-Crit
Between Groups	2916410	1	2916410	0.363978	0.555954	4.60011
Within Groups	1.12E+08	14	8012602			
Total	1.15E+08	15				

The mean level of owned funds (6740) is less than that of borrowed funds (7593.875). According to the test result, F=0.363978. With a critical value of 0.05, the critical F=4.60011. Since the F statistic is smaller than the critical value, we reject the null hypothesis and say that there is significant difference between the owned funds and borrowed funds of the RRB.

Deposits and Loans Outstanding of RRB

The businesses performance of RRBs in terms of deposit mobilization and credit extension is presented in Table-6. RRB is showing considerable improvement in their credit and deposits performance. The deposits mobilized by the bank has been increased from Rs.62, 143 crore in the year 2008-09 to Rs.1, 20,189 crore in 2012-13. The increase over the period was 93.40%. Loans outstanding of the RRBs also highlighted the significant improvement as it has been increased from Rs.32,870 crore in the year 2008-09 to Rs.67,802 crore is 2012-13. The increase over the period of the study was 106.27%.

Table 6 *Deposits and Loans Outstanding of RRB in India (Rs in Crore)*

Years	Deposits	Loans
2008-09	62,143	32,870
2009-10	71,329	39,713
2010-11	83,144	48,493
2011-12	99,093	58,984
2012-13	1,20,189	67,802

Source *NABARD*

Performance Comparison of Deposits and Loans Outstanding of RRB: The performance of the pre-merger period and post-merger period in respect of deposits and loans outstanding of the RRBs were compared using ANOVA to test whether the merger process has resulted in improving the performance of these banks in respect of deposits and loans in India during the study period. The test results are given in Table-7.

Ho: There is no significant difference in performance between deposits and loans of the RRB.
H_1: There is significant difference in performance between deposits and loans of the RRB.

Table 7 *ANOVA (Single Factor) (Deposits and Loans of RRB)*

Summary

Groups	Count	Sum	Average	Variance
Loans	5	314763	39345.38	3.17E+08
Deposits	5	337810	42226.25	1.29E+08

ANOVA

Source of Variation	SS	df	MS	F	P-Value	F-Crit
Between Groups	33197763	1	33197763	0.148846	0.70544	4.60011
Within Groups	3.12E+09	14	2.23E+08			
Total	3.16E+09	15				

The mean level of loans (39345.38) is less than that of deposits (42226.25). According to the test result, F=0.148846. With a critical value of 0 .05, the critical F=4.60011. Since the 'F' statistic is smaller than the critical value, we reject the null hypothesis and say that there is significant difference between the deposits and loans outstanding of the RRB.

Growth of Investments

There has been consistent growth in the sphere of investment activity. Investment as a window of deployment of funds was given more emphasis than lending. It has been observed from the Table-8 that the amount of investment of the bank has been increased from Rs 36,762 crore in the year 2008-09 to Rs 65,910 crore in 2012-13. The year 2012-13 registered at a highest percentage.

Table 8 *Growth of Investments of RRBs in India (Rs in Crore)*

Years	Amount of Investment	% of Increase over Previous Year
2008-09	36,762	- -
2009-10	41,182	12.02
2010-11	45,666	10.88
2011-12	48,560	6.33
2012-13	65,910	35.72

Source *NABARD*

7. Findings

The performance of Regional Rural Banks, an attempt has been made to analyze the performance in terms of certain defined parameters like number of branches, capital funds, and mobilization of deposits, loans and investments made by these banks. The performance of RRB in India improved in the post-merger period.

Even though number of RRBs decreased, the branch network has been increased. During post-merger period, there has been increased number of districts covered by the RRBs. Total capital funds have been increased enormously after amalgamation took place during the year 2008-09 to 2012-13.

The process of merger should not proceed beyond the level of sponsor bank in each state. The findings may be of considerable use to rural banking institutions to occupy an important position in the rural credit market of India. The Reserve Bank of India has already set targets for reaching more villages. RRB should extend their services in to un-banked areas and increase their performance growth.

8. References

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