Policy Paper

Regional Rural Banks and Financial Inclusion: Policy Imperatives

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Regional Rural Banks and Financial Inclusion: Policy Imperatives

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Executive Summary

The RRBs were established in India under the RRB Act, 1976 with a view to develop 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 labourers, artisans and small entrepreneurs and for matters connected there with and incidental thereto. In the initial stages during the 1970s and 1980s, RRBs were seen as primarily catering to the BPL population by lending to them towards meeting their investment needs. But after the debt waivers of the early 1990s, the repayment problems of the rural banking system began to be magnified with a subsequent contraction in the flow of credit to small borrower accounts through the banking system. The recapitalization of RRBs during 1994-2000, along with a reorientation towards profitable functioning helped to restore the fortunes of RRBs. Thereafter the process of amalgamation which was started in 2005 has resulted in the number of RRBs being brought down from a peak of 196 to 57 at the end of 31 March 2014.

RRBs serve scattered and less profitable clientele with low ticket sizes of loans under stringent priority sector lending norms and other delivery constraints. RRBs are thus filling the gaps which commercial banks are not able to cover. In recent years RRBs have maintained stable growth in assets of around 16% during 2013-14. As per the provisional results, all the 57 RRBs reported profit in 2013-14 with their net profits going up by 18.5% during the year.

Out of the total RRB loan outstanding of Rs. 1,59,000 crores, Rs.82,000 crores is the ground disbursement. 62% of clients are small and marginal farmers (table 1). However the question remains, have RRBs gone down market as much as they could?

RRBs opened 3.02 crore accounts under PMJDY as on 15.07.2015, or nearly 18% of total accounts. Of these 2.57 crore accounts were in rural areas representing over 25% of the total 10.21 crores accounts opened in rural areas. RRBs accounted for nearly Rs. 3,500 crore out of Rs.20, 288 crores of deposits, representing over 17% of the balances in these accounts. Out of these newly opened accounts the proportion of zero balance accounts is 50%. RRBs have also opened 440,000 accounts in urban areas. The number of RuPay debit cards issued by RRBs was 2.19 crores, out of a total number of 15.05 crore such cards issued by all types of banks. Apart from opening PMJDY accounts, RRB have offered a range of products and

Table 1: Purpose-wise Outstanding Advances by RRBs

Sr. No.	Purpose	As on 31 March (Rs. in Crores)		
		2012	2013	2014*
	Total loans outstanding	**116385**	**139652**	**159302**
(a)	Share of agri to total loans o/s	54.84	53.84	56.68
(b)	Share of term loans to total loans o/s	14.81	13.89	13.78
(c)	Share of Priority Sector (% to total)	82.09	80.06	81.74

* Provisional **Source: DFS (2015)**

developed infrastructure support for financial inclusion. These includes, apart from more conventional products, varied innovations such as business correspondent (BC) centres, mobile ATM vans, doorstep savings collection, use of self help group members as BC agents, dedicated products for specific groups and financial product help lines.

Nevertheless, there are some disquieting features regarding the financial operations of RRBs. The RRBs substantial undertake investments in government securities and with the sponsor banks such that a large proportion of the deposits mobilized are not lent to the intended beneficiaries. Otherwise, RRBs could have catered, at more than competitive interest rates, to self-help groups (SHGs) and the clientele of the present-day MFIs. Indeed, RRBs have not even supported MFIs with term loans for their retailing function to this segment.

RRB efforts at financial inclusion are circumscribed since RRB lending rates are constrained by interest rates available through commercial and cooperative banking channels and the interest subsidies and subventions provided by the state in various regions and contexts. The BC model, however, holds promise of providing the last mile connectivity. However, the viability of this channel has yet to be established.

The role of the RRBs in financial inclusion policy and practice presently is unclear and nebulous as new entities are being created particularly in the rural banking space. There appears to be a potential surge in the availability of financial services to medium scale enterprises and middle income groups which too have probably not received their fair quantum of services over the years. The introduction of differentiated banking and the licensing of small finance banks and payments banks raise the question how the activities of these entities with overlapping functions and clientele as RRBs would impact on the relevance and viability of the latter. Proposals for a further round of amalgamation of RRBs into state-level entities could also further distance them from their original mandate and clientele.

The amendment to the RRB Act passed in April 2015 facilitates the raising the share capital of RRBs from the present Rs. 5 crore to Rs. 2,000 crore, infusing capital from other than the present owners to the extent of 49 per cent against the present arrangement of the Centre, States and sponsor banks sharing in the ratio 50:15:35 respectively. These changes will pave way for their part privatization and pure commercialization, ignoring the very purpose of their birth and could help to further distance the rural poor from the access to institutional credit. RRB staff has proposed that instead a small further dose of capital support from government would have put the RRBs on a sound footing. In any event, going forward there could be a process of differentiation with the best placed RRBs attracting additional capital from private sources even as the other less successful ones await fresh capitalization or further round of amalgamation.

Summing up, in respect of the RRBs the following major issues and questions need to be addressed:

Positioning of RRBs in the Financial Architecture: What happens to the role of RRBs with the emergence of new players in their area of operations? Are RRBs to scale-up through privatization and to be moved up in the financial value chain? How is that going to affect their ability to serve their original mandate?

Viability of RRBs: Where RRBs are still being directed to the lower profitability business/remote areas by the parent banks, then how is the viability issue to be resolved? How can they meet the same profitability standards as other scheduled banks? Is an alternative social accounting frame to be adopted for RRBs in view of their special charter and area of operations?

Investment Issues: What incentives can be created to break the dependence of RRBs on sponsorship banks for off-take of their investment funds?

Human Resources and Technology: How can human resources and technology be creatively employed in the interests of efficient RRB functioning?

Financial Inclusion: How natural partners such as SHGs and the existing MFI network can be utilized through appropriate business models from widening and deepening of the provision of RRB financial services for the unbanked and under-banked sections of the rural population?

Besides, feedback from the leadership of selected RRBs interviewed highlighted the need for a range of specific measures such as: (i) clearance for mobile technology; (ii) reduced statutory liquidity (SLR) requirements; (iii) high interest charges on NABARD refinance; and (iv) a variety of issues with sponsor banks related to operational issues, treasury management, human resources and staffing of bank branches, ATM charges, technology upgradation, financial literacy, etc.

This will require sustained support from the sponsor banks, RBI and NABARD to address the various policy issues in delineating and strengthening the role of RRBs of financial inclusion.

Way forward:

Both at the level of RBI and NABARD on the one hand, and the sponsor banks on the other, a range of policy and regulatory norms and measures have been identified that need to be considered to better direct the RRBs in the service of the relatively poor and unbanked clients. In fact, especially with the advent of more players in the space for providing financial services to SMEs, it is an opportune moment for the RRBs to re-examine the place of the poorest segment in their operations and lending portfolio. Several elements of the new financial inclusion thrust offer both the methodology and the institutional innovation to forge partnerships with MFIs and other agents, to provide services to the poor segment. Adoption of the BC channel as well as provision of wholesale funding to MFIs could be options. There is need to revisit the RRBs old relationship with SHGs through bank linkage, where experience shows that a critical mass of clients aggregated through this agency or cluster-level federations could lead to viable operations. Such an approach could help both to reposition RRBs as development oriented banks in the service of the poor, as well as to be in harmony with the objectives and programmes of financial inclusion.

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1. Background

The genesis of the RRBs can be traced to the need for a stronger institutional arrangement for providing rural credit. The launch of regional rural banks (RRBs) can be seen as a unique experiment and experience in improving the efficacy of rural credit delivery mechanism in India. RRBs have been in existence for around four decades with the objective of deepening the outreach of the banking system to serve specific population segments. A RBI Working group under M. Narasimham conceptualized the creation of RRBs in 1975 as a new set of locally-oriented banks serving rural areas, which would combine the feel and familiarity of rural problems characteristic of cooperatives with the professionalism and large resource base of commercial banks. An effort was made to integrate commercial banking within the broad policy thrust towards social banking keeping in view the local conditions with joint share holding by Central Government, the concerned State Government and the sponsoring banks. Subsequently, the RRBs were set up through the promulgation of RRB Act of 1976 with their equity held by the Central Government, concerned State Government and the Sponsor Bank in the proportion of 50:15:35. Thus, RRBs were supposed to evolve as specialised rural financial institutions for developing the rural economy by providing credit to small and marginal farmers, agricultural labourers, artisans and small entrepreneurs.

Over the years, the RRBs, which are often viewed as the small man's bank, have taken deep roots and have become a sort of inseparable part of the rural credit structure. They have played a key role in rural institutional finance in terms of geographical coverage, clientele outreach and business volume as also contribution to development of the rural economy. A remarkable feature of their performance, especially over the past three decades or so has been the massive expansion of their retail network in rural areas. However, all along this process the viability of RRBs remained a challenge, and their balance sheets remained weak, requiring doses of capitalization.

From a modest beginning of 6 RRBs with 17 branches covering 12 districts in December 1975, their number grew into 196 RRBs with 14,446 branches working in 518 districts across the country. By March 2004 RRBs had a large branch network in the rural areas forming around 43 per cent of the total rural branches of commercial banks. The rural orientation of RRBs was formidable with rural and semi-urban branches constituting over 97 per cent of their branch network. The growth in the branch network enabled the RRBs to expand banking activities in the unbanked areas and mobilise rural savings.

To address concerns about the viability of RRBs, in 2001 RBI constituted the Dr V S Vyas Committee on "Flow of Credit to Agriculture and Related Activities from the Banking System" which examined the relevance of RRBs in the rural credit system and the alternatives for making them viable. Several other committees also suggested the creation of viable RRBs through a process of amalgamation. The consolidation process thus was initiated in the year 2005 as an off-shoot of the Vyas Committee recommendations. The first phase of amalgamation was initiated Sponsor Bank-wise within a State in

2005 and the second phase was across the Sponsor banks within a State in 2012. The process was initiated with a view to provide better customer service through improved infrastructure, computerization, experienced work force, common publicity and marketing efforts, etc. The amalgamated RRBs also benefit from larger area of operation, enhanced credit exposure limits for high value and diverse banking activities. As a result of amalgamation, the number of the RRBs has reduced from a peak of 196 to only 64 as on 31 March 2013. The number of branches of RRBs, however, increased to 17,856 as on 31 March 2013 covering 635 districts throughout the country. The process of amalgamation has continued and there were 57 RRBs amalgamated bank-wise at the state level as of July 2014.

The RRB Act which was being considered by the parliamentary standing committee on finance has been passed in April 2015. The amendments therein are aimed at increasing the pool of investors to tap capital for RRBs. Thus government is exploring a new class of investors in public sector banks. Government has also been making various efforts to make RRBs a profitable institution by infusing fresh capita, allowing RRBs to lend for commercial projects, consortium finance, foreign currency, and insurance business on referral basis. RRBs are also moving towards CBS for effectiveness and to increase the customer base. All RRBs are already on the CBS platform. As a strategy to advance financial inclusion in the country the RRBs presently have undertaken an aggressive branch expansion programme, RRBs opened 913 and 947 new branches during 2011-12 and 2012-13 respectively. During 2013-14, the RRBs have opened 438 branches taking the cumulative number of branches to 19,082 as on March 31, 2014. The provisional financial results of RRBs for the year 2013-14, indicates that all of 57 RRBs have earned profits aggregating INR 2,833 crores, showing good financial recovery. Neertheless it has also been argued that there has been mission drift in their functioning since their inception.

The rapid expansion of RRB has undoubtedly helped in reducing substantially the regional disparities in respect of banking facilities in India. The efforts made by RRB in branch expansion, deposit mobilization, rural development and credit deployment for weaker sections of rural areas are substantial and wide-ranging. RRBs have largely been successful in taking banking to rural households, particularly in banking deprived rural areas, and to make available easy and cheaper credit to weaker rural sections who have been traditionally dependent on private lenders; to encourage rural savings for productive activities; and facilitating enterprise and employment, while at the same time bringing down the cost of credit in rural areas. Thus RRBs have played a significant role in strengthening the banking network in India. However, despite all these efforts and the recent introduction of new niche banks, it could be challenged whether RRBs are playing the role for which they had been formed.

2. Rationale and Scope of the policy paper

Regional Rural Banks have been playing a key role as an important vehicle of credit delivery in rural areas with the objective of credit dispersal to small, marginal farmers & socio economically weaker section of population for the development of agriculture, trade and industry. However, their commercial viability has been questioned due to their limited business flexibility, smaller size of loan and high risk in loans and advances.

Although RRBs had a rapid expansion of branch network and increase in volume of business, these institutions went through a difficult evolutionary process. Some of the problems with the functioning of RRBs have been identified as[1]:

- Limited area of operations
- High risk due to exposure only to the target group
- Mounting losses due to non-viable level of operations in branches located at resource-poor areas
- Heavy reliance on sponsor banks for investment avenues
- Burden of government subsidy schemes and inadequate knowledge of customers leading to low quality assets
- Unionized staff with low commitment to profit orientation and functional efficiency
- Inadequate skills in treasury management for profit orientation
- Inadequate exposure and skills to innovate products limiting the lending portfolios
- Inadequate effort to achieve desired levels of excellence in staff competence for managing the affairs and business as an independent entity

It is also felt that rural banks are characterized by a lack of transparency in their operations which leads to unequal relationship between banker and customer with many rural customers also unable to avail banking facilities at the existing branch locations. In this competitive era, RRBs would need to concentrate on speedy, qualitative and secure banking services to retain existing customers and attract potential customers. While some answers are being found in the new financial inclusion strategy other issues remain along with fresh challenges posed by the emerging financial architecture.

The present policy paper is envisaged to analyze the current status andmandate of RRBs in India and their potential to contribute in last mile financial inclusion. The paper proposes to undertake documentation and analysis of the intention and efforts of RRBs in this direction so that an advocacy plan for supportive policies for RRBs can be developed under the larger scale financial inclusion programme.

Given the above framework, the paper aims to:

- Understand RRBs' mandate and their role in contributing in financial inclusion in India

[1] MCril (2008) and others.

- To evaluate the progress and growth-pattern of RRBs in India (analyze credit portfolio, client profiles, their NPAs across the portfolio, credit bureau usage)
- Analysis of of other services offered such as insurance, pension etc and success with implementation of BC model
- The nature of challenge that the RRBs will face once the new generation small finance banks roll out their operations
- Assess the readiness/willingness of the existing RRBs banking structure for undertaking the campaign for financial inclusion under Jan Dhan Yojana (JDY)
- Review the technology being used by the RRBs within the banking system and areas of improvement.
- To make suggestions to improve the working of RRBs towards comprehensive financial inclusion.

3. Objectives and Methodology

The purpose of this policy paper is to understand RRB's mandate and their role in contributing in financial inclusion in India. Basically, apart from the usual look at performance and coverage especially with regard to Financial Inclusion(FI) and the progress and participation the Prime Minister's Jan Dhan Yojana (PMJDY), it is intended to ascertain primarily from the RRB leadership how they see their role in the present and emerging financial architecture, what are the outstanding issues, what is the kind of support they are receiving and they would like to receive from sponsor banks and other government agencies in pursuing their role, and what specific policy suggestions they would like to offer to RBI/GOI towards their effective functioning.

Highlighted below are some of the broad objectives and issues covered in the paper.

- pattern of lending for RRBs, i.e. distribution of portfolio including NPAs
- Evaluation of progress made by the RRB under PMJDY with latest data
- Assess the readiness/willingness of the existing RRBs banking structure for financial inclusion under Jan Dhan Yojana.
- Examples of best practices, and brief caselet/documentation of important innovations in FI and undertaken by the RRB
- The nature of challenge that the RRBs will face once the new generation small finance banks roll out their operations
- The technology being used by the RRB within the banking system and ways of improvement.
- To make suggestions to improve the working of RRB, particularly in the policy sphere.

Further it also looks at:

- An understanding of the RRB's experience with the BC model, the degree of success in implementation and the issues related to it, along with areas of support required
- Support from parent banks - to what extent available, what are the shortcomings, and possible solutions.
- Offering of other services by the RRBs such as insurance, pension etc and credit bureau usage
- Reaction of RRB leadership and other stakeholders to the amendment of the RRB Act undertaken by Parliament on 28 April - does it address RRB concerns?

The policy paper is based on primary and secondary data on Regional Rural Banks in India. It includes:

- Visits and structured interviews with RRB leadership and line managers in PSIG states of U.P. and Bihar and other well-performing RRBs in Andhra Pradesh and Karnataka focusing on their role and challenges for financial inclusion and policy issues.
- Interviews/consultations with NABARD, Sponsor Banks, and sector experts.
- Secondary literature, including studies and policy documents from various official sources such as RBI, DFS, NABARD, etc. apart from research studies of independent scholars and agencies.
- Policy discourse around the emerging financial architecture in its significance for the RRBs
- Latest data on RRBs outreach and performance from RBI and DFS.
- A few case studies of successful innovations of RRBs operating in India

4. Experience of nearly 40 years of RRB operations:

(i) Changing Role and Expectations of RRBs

The RRBs were established in India under the RRB Act, 1976 “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 labourers, artisans and small entrepreneurs, and for matters connected therewith and incidental thereto.”

Such a step was found necessary since the Banking Commission in 1972 observed that despite expansion of the commercial bank network after nationalisation, there was still a need for having a specialised network of bank branches to cater to the needs of the rural poor. RRBs thus were intended as rural-oriented commercial banks with the low cost profile of cooperatives but the professional discipline and modern outlook of commercial banks. However, despite the deregulation of interest rates in 1996 on small loans their financial viability continued to a major issue that needed to be addressed through policy reform involving recapiltalization, amalgamation and other measures.

Regional Rural Banks (RRBs) thus have been a familiar player in the rural financial landscape for some time. This period of nearly 40 years has been characterized by these banks, as a whole, treading a path that has gone through differing phases of evolution and growth. An initial phase of expansion between 1975 and 1987 was followed by a period during the 1990s of accumulated losses and attempts at recapitalization towards financial viability. However, in the very first decade of the setting up of RRBs, 152 out of 188 RRBs had accumulated losses of Rs 340 crores. The losses went up sharply in 1992 on account of implementation of the National Industrial Tribunal Award bringing parity in wage structure of RRBs with that of commercial banks. This negated the low cost structure of RRBs and more losses were accumulated. The government took note of the grim situation of RRBs and several committees were set up to look into various problems and issues faced by RRBs. Over the period 1994-2000, 187 RRBs were provided with a total of Rs 2188 crores for recapitalisation (Mahajan, 2004).

As noted by RBI (2007), the performance of RRBs during the last three decades can be categorized into three phases as follows: (i) 1975 - 1986 - Expansion Phase; (ii) 1986 - 1995 - Declining Phase; (iii) 1995 - 2006 - Turn Around Phase. In the latest phase, as the effects of various policy interventions, significantly through the amalgamation of weak RRBs with stronger ones belonging to the same sponsor banks in the states, a period of apparent stabilization into a profitable and viable regime appears to have been reached. However, RRBs slowly moved away from their initial focus and the mandate of inclusion such that there became not much difference between RRBs and commercial banks except physical presence in rural areas. Thus, *the discourse around RRBs can be seen as being dominated by issues related to high expectations, operational constraints, role of sponsor banks and the question of mission drift*.

In the initial stages during the 1970s and 1980s, RRBs were seen as primarily catering to the BPL population by lending to them towards meeting their investment needs, as part of a programme of poverty alleviation as embodied in the IRDP. Indeed, the RRBs were expected to cater to even a lower rung of extreme poor population, with household income of less than Rs. 2000 per year, at a time when the poverty line was set at Rs. 4800 per year. It would appear that in the first phase, RRBs did attempt to reach the targeted population. Thus, a study by Burgess and Pandey (2005) could assert that in the Indian context, *expansion of rural bank branches (mainly RRBs) had been a major factor in the progress made in poverty reduction during the period*. However, after the debt waivers of the early 1990s, the repayment problems of the rural banking system began to be magnified with a subsequent contraction in the flow of credit to small borrower accounts through the banking system. (Incidentally this, in turn, helped to create the space for a new set of stakeholders and players in providing credit to the weaker sections of society in the form of Microfinance Institutions (MFIs) and Self-Help Groups (SHGs) linked to banks.) Indeed, during 1999-2000 it was possible for the CEO of one of the leading MFIs to offer to buy a loss making RRB for Re. 1 and to turn it around towards profitable functioning in delivering financial services for poor families. The recapitalization of RRBs during the period 1994-2000, along with a reorientation towards profitable functioning through increased non-priority sector lending opportunities (the mission drift), helped to restore the fortunes of RRBs which were otherwise headed on a downward path. Thereafter the process of amalgamation, which was started in 2005, has resulted in the numbers of RRBs being brought down from a peak of 196 to 57 at the end of 31 March 2014.

The ownership of RRBs is vested in the Government of India (50 per cent), sponsor bank (35 per cent) and the state government (15 per cent). Out of these, however, it is the sponsor bank that is both the primary stakeholder as well as the agency with the knowledge and expertise to direct and support RRB operations. Within the parameters set for RRB functioning, it is inevitable that the role of the sponsor bank is a key factor in determining the performance of the RRB. It has been argued that the performance of a RRB is determined by the nourishment it receives from the sponsor bank, by way of direction, investment and hand-holding. This 'umbilical cord' relationship (Malhotra, 2002) has been used to correlate the performance of RRBs with the support provided by the sponsor bank. Considering 22 different parameters that impact on the functioning of the RRBs for the year 2000 Malhotra asserted that the geographical location of RRBs was not the limiting factor for their performance, but "it is the specific nourishment which the RRB receives from its sponsor bank is cardinal to its performance."[2] Misra (2006) in a study of all RRBs over a ten-year period till 2003-04, found thatthe *performance of the sponsor banks in past years had a significant impact in the current year for both profit and loss making RRBs*. Misra concurred that the profit making RRBs were able to reap the synergy from their association with the sponsor bank, while the sponsor bank acted as a drag on the financial health of the loss-making RRBs. Malhotra had recognized several reasons for this phenomenon. These included *competition for business rather than co-operation between the RRB and the sponsor bank in the same geographical area and the absence of its support in financial decisions, meeting skill requirements, investment management, etc*. Overall Misra's results indicated that the 'umbilical cord' hypothesis was operational and sponsor bank inputs key to an RRB's fortunes.

During the past ten years, since 2004 or so, as the process of recapitalization and subsequently amalgamation of RRBs has been completed, there have not been any significant studies that have analyzed the factors responsible for the transformation in the health of the reconstituted RRBs. Overall the impression remains that the RRB turnaround has been accompanied by mission drift and an implicit urban bias, in that perhaps *nearly 50 per cent of RRB's portfolio could well be directed at urban, rather than rural, clients, and towards larger loans in sectors and sub-sectors that nevertheless carry the priority sector tag*. In fact, the portfolio breakdown of RRB lending, according to type of client, is difficult to come by in order to ascertain the extent to which the RRBs servicing the original target groups. Even the extent of RRB lending to SHGs, for example, as a percentage of the total loan portfolio is not easily available.

In any event, *the RRBs are an amorphous collection of banking entities, of varied sizes and activity levels that are variously constrained and operationalized by factors such as sponsor bank inputs, regional factors, nature of markets and the need to comply with RBI and Central government directives*. This, in turn, affects the extent of their involvement thus far in providing financial services to unbanked and under-banked sections of the population. Thus, RRBs in one region may appear to be heavily

[2] Soni and Khapre (2012).

involved in lending to SHGs in terms of a significant proportion of their portfolio, while in others the share of SHGs may be marginal. Besides, RRBs may find themselves competing with commercial banks and cooperative banks to varying degrees in their varied geographical locations. Accordingly, the objectives, products and strategies, performance and impact of RRBs are found to be extremely varied across the now 57 banks in India. It may also be noted that *the period of 'mission drift' and movement towards greater capitalization, amalgamation and profitability has also been characterized with the RRBs losing their own separate identity as a financial services provider. As such RRBs are presently more or less subsumed within the scheduled commercial banks (SCB) sector*. In fact, a case in point is that the Mor Committee Report (2014), which serves to plan a differentiated banking model in order to create a new financial architecture, does not appear to appreciate the differentiated nature of RRBs from other SCBs in terms of the history of their formation and their intended clientele. Though many of the RRBs have become fairly large banking agencies with a large network of branches in their operational areas (with the largest RRBs having more than 1200 branches), entities such as payments banks and small finance banks that are being launched, as part of the differentiated banking approach, would find themselves to be seriously overlapping in the banking space presently occupied by RRBs. Similarly, there is an ambiguity about entities created such as the MUDRA refinance agencies - whether they are to lend to RRBs, which may then on-lend to MFIs or to Non-Banking Finance Companies (the NBFC-MFIs) directly. [In fact the relationship between RRBs as a source of loans to the MFIs has not been clearly established. Possibly in view of the uncertainties related to the fate of MFIs in India, the RRBs have not been a major source of funding for MFI-lending operations. It is only recently that RRBs have started lending to some of the larger MFIs in the southern states.] This also raises the question whether the RRBs are to occupy purely a retail space in the financial inclusion drive or can be part of an on-lending relationship with MFIs – and possibly even with the newly emerging small finance banks. Hence, *it could be argued that the role of the RRBs in financial inclusion policy and practice is still unclear and nebulous, and attempts to create new entities and new programmes have taken scant notice of this important player, particularly in the rural banking space that is already in existence*.

(ii) Issues in RRB Performance and Operational Viability

(a) Performance-related issues

As also briefly discussed earlier, there have been concerns about the performance of RRBs right since their inception. A closer look at the performance related issues follows. Despite the fact that over the years their role and operations have been recast through various measures taken, some intrinsic features of their functioning have been responsible for the patchy performance over the years. In addition to this, it could also be argued that given their mandate, RRBs could not deliver on profitability precisely because of their structural features and the target clientele. According to the RBI, the key factors having an effect on RRB performance according to the RBI (Sardesai) Internal Working Group 2005 are given in Box 1. These cover a large range of issues that continue to be a feature of RRB operations. However, no lasting solutions appear to have been forthcoming to deal with this long list of pertinent issues.

Box 1

Factors affecting RRB performance

According to the RBI Internal Working Group 2005, the key factors having an effect on RRB performance were:

- **Limited area of operation** with a narrow range of business activities and small base of clients leading to high covariant risk;
- **Focus on small customers** such as small and marginal farmers, small transport operators, small and
  micro-enterprises and SHGs with limited credit requirements making it impossible to earn bulk incomes from larger, high income borrowers to cross-subsidise lending to the main customer group;
- **Perception as an instrument of social policy** without viability considerations while there was pressure to improve financial performance, resulting in uneven growth;
- **A capital base that was too low for their business volume** resulting in a serious prudential hazard whereby hundreds of crores rupees of deposits were underpinned by just Rs 1 crore of capital. 39 out of 96 banks extant on 31 March 2007 together reporting accumulated losses in excess of Rs. 2,700 crores.
- **Small organizational structure and limited financial assets** came in the way of garnering a larger share of the rural financial market by making it difficult to provide a full range of financial services, thereby discouraging large depositors and borrowers.
- **High loan delinquencies** resulting from their use for directed lending by the State
- **High cost of servicing numerous small accounts with i**nterest charged to customers having to be kept in line with the competing commercial banks
- **Poor financial skills** resulting in an inefficient allocation of resources and parking of large amounts with sponsor banks
- **Conflict of business interests with sponsor banks** that operate in the same areas but have been responsible for the financial and business initiatives of their RRBs
- **Lack of professionalism in management** as senior managers (including Chairmen) are appointed out of the serving officers of the sponsor bank which results often in the reference of small matters to the sponsor with consequential delays in decision making. [It also results in short terms for Chairmen, and the notion that the job is a 'punishment'.]
- **Lack of skilled staff** resulting from inappropriate training and lack of exposure to new products and development activities for catering to the changing requirements of the rural sector. An ageing staff profile resulting from the ban on recruitments has constrained efficiency in operations and uniform norms and policies across the country ignoring local issues and conditions have lowered staff morale reducing involvement in development tasks
- **Inappropriate wage structure** which was brought in line with the higher wages of the commercial banks even as RRBs were required to retain their rural flavour to identify with the rural population
- **Administered interest rate regime** that depressed rates since they were lending to the "weaker sections and yet were required to pay a slightly higher rate than commercial banks on deposits.

Source: RBI Working Group on RRBs, 2005 as reported in MCril, 2008.

Besides the factors identified above, the boards of RRBs were not of persons with experience of running banks or building banks. Also, RRBs did not have customer responsive products and services. They fell in to the trap of larger banks (their sponsors) – implementing schemes and centrally designed products which branches could distribute. It is clear that RRBs had right from the outset been directed into a space where profitable operations would be extremely difficult due to the small ticket size of the financial products, the scattered clientele and relatively large human resource burden on account the need for parity with the commercial banks salary structures. As such, as emphasized by the RBI Task Force for Empowering RRB Boards for Operational Efficiency (2007) in view of the policy and administrative constraints impinging on their performance *there is need for accommodation in terms of performance assessment, which should not be purely directed by standard profitability criteria adopted for commercial banks.* Commentators also support a blend of the central and the progressive elements of the `RRB innovation' while pursuing a `nuanced' criteria of viability, which must necessarily be different from the present benchmarks of banking performance (Bose, 2005). It may be observed that priority sector lending criteria are more stringent than for commercial banks with 60 per cent of their portfolio required to be directed at the priority sector[3]. As a result, RRBs are denied more profitable avenues of lending operations, which carry higher margins. Similarly they are constrained in deposit mobilization by being unable to offer higher deposit rates like cooperative banks. In fact, interest rate freedom is a mirage, even today for banks. The limited profit margins that inevitably accrue to RRBs have not been seriously examined as a constraint to their expansion and growth. *Several RRB chairmen, in fact, argue for a level playing field by which they can compete with commercial banks on an even footing towards increased profitability*. Successive wage awards and legislation have also led to the human resources of RRBs to being paid wages and salaries on par with commercial banks. Due to the above constraints, the RRBs are mainly unable to attract funds from the sponsor banks, and indeed tend to park savings deposits they mobilise with the sponsor banks as well. The latter makes them more investment-oriented than credit-oriented. Thus, *with new banking licenses that are being provided to a fresh set of players, there is going to be an even larger competition for mobilization of savings which will leave the RRBs adversely placed*. The call is already out for a second round of amalgamation, by which the RRBs will be reduced to only one in each state through the amalgamation of existing RRBs of different sponsor banks. *Such an amalgamation is expected to yield benefits of economies of scale towards more efficient and profitable functioning, even though it is not clear why and how scale benefits would not already have been realized at the level of current operations*. Uncertainties of and resistance to amalgamation across banks could also result. Besides this could serve to propel these RRBs even further away from the rural poor population which they had been initially intended to serve and may further transform their character, moving them away from genuine financial inclusion, apart from that required through directives from government authorities. Consequently, the *RRBs are extremely precariously*

[3] With a view to providing more credit to the segments under priority sector, it was decided that RRBs should achieve a target of 60 per cent of their outstanding advances for priority sector lending as against 40 per cent earlier. Further, of the total priority sector advances, at least 25 percent (i.e. 15 percent of the total advances) were required to be advanced to weaker sections of the society. The revised targets were made effective from the year 2003-04 (RBI, 2013).

placed in terms of their positioning within the financial infrastructure, particularly in terms of their role in financial inclusion.

Finally, the RRB must also rest at an important point in the debate about differentiated banking, discussed in greater detail below. While *differentiated banking* appears to be the flavor of the times, there is no clear reason to suggest that this should be a preferred regime for financial services delivery. Commercial banks, both through tie-ups with insurance companies and other service providers, as well as through the development of their own insurance and remittance services channels, have been working towards a *universal banking model* that provides a suite of financial services to their clients under one roof or through one account. There are many economies of scale and economies of scope associated with such integration of financial services by the banking system. In fact, even the Jan Dhan Yojana and the Bima Suraksha Yojana envisage a set of products and services based upon a banking account for every individual which in turn is being extended to payment operations with the help of the unique *Aadhar* identity. It is therefore questionable whether the new banking entities sought to be created under a layered and differentiated banking infrastructure can supplant, supplement or augment the role being played by RRBs in providing services to the rural population and the weaker unbanked sections.

(b) Targeting and Viability of RRB Operations

An issue that comes up often relates to the profitability of RRBs in serving unbanked and low-income clients. As discussed elsewhere, there is a case for developing alternate performance criteria for this institution, which operates under several constraints set by the banking regulator. As also pointed out by a discussion group on RRBs and financial inclusion, it was envisaged and further endorsed by Narasimhan Committee Report of 1975 that RRBs would incur some losses in the process of helping the poor. These losses could be considered as the necessary social cost for achieving the social benefit in terms of developing the rural economy for the benefit of the poor in India (UNDP, 2012). The members felt that the *restructuring of RRBs with the overwhelming concern of their viability have distanced them from the poor through transforming the RRBs into pure commercial banks from pure social banks*.

Nevertheless, it is inevitable that RRB leadership, particularly when controls on lending rates have been lifted and there is a degree of flexibility to solicit a more profitable clientele, tends to neglect their original target group. At the same time, there are virtually no credible studies that enlighten us on the cost of lending and the profit margins associated with different components of the RRB's lending portfolio. Broadly speaking, the SHG portfolio of an RRB can be seen to represent a component that is directed to a more inclusive approach to saving and lending operations aimed at the poor and those with poor access to financial services. In fact it had been seen as an important innovation serving to bring down the transaction costs of bank lending to this category of largely women borrowers. SHG lending is usually not more than about 5-10 % of total lending for most RRBs. However, this could go up to 20 to 25% in certain areas such as Andhra Pradesh where there has been a sustained government campaign of SHG formation and support towards bank linkage. The general impression is that SHG lending, given its well known features and limitations, is unviable for banks. RRBs are also constrained to charge rates in line with commercial banks and other parameters of subsidized lending. The general impression is that SHG lending is unviable. Even so, while some RRBs with a large SHG portfolio assert that SHG lending is profitable, researchers have also tried to suggest to the contrary. Besides, there is no clear evidence that financial inclusion through SHGs or the more recent initiatives involving banking correspondents and other types of intermediaries can be profitable for the RRBs.

As a result, even in India, in the absence of knowledge about costs of providing services to different segments by the RRBs, it is not possible to clearly pronounce on the viability of different segments of its portfolio. Even so there is often a case made out for RRB operations catering to the target group of the vulnerable rural sections through cross subsidization of their operations. Thus it is proposed that they should be agencies with the exclusive goal of financial inclusion. Instead of profit, their goal can be 'no loss, no profit' and if they fail to cover the costs they need to be subsidized by their sponsors who can earn that much profit from their own business. In an earlier era the case for amalgamation of RRBs into state or zonal level entities under an apex banking institution or NABARD was promoted by the All India Regional Rural Bank Employees Association in order to ensure "unity of command and cross subsidization" (Bose, 2005).

It would be worth mentioning however, that a one-of-its-kind study of viability analysis of SHG lending by a RRB branch in Alwar, Rajasthan (Meissner, 2006), given the methodology adopted, noted that *it was possible to conclude that transaction costs and cost of risk of SHG lending by the RRB branch were covered and that SHG lending was more profitable than normal lending* - with linkage banking being a viable business once certain scale was reached. An understanding by the branch manager and bank management in promoting SHGs as a long-term investment in a reliable client was a necessary condition for viable and profitable SHG lending by the RRB branch.

Similarly, an enquiry into the outreach-viability conundrum, Sinha, et al. (2003) had concluded from a study of five RRBs that though there was a shift away from serving low-income clients, neither outreach nor economic environment were substantial impediments to financial viability. *The more successful RRBs continued to serve predominantly low income clients and it was their better management incorporating a reasonable focus on lending and diversified portfolios with good repayment performance that enables them to perform better*. The successful RRBs essentially outperform their peers on account of their superior operational strategies enabled by better leadership.

Harper and Arora (2005) had hypothesized that downscaling of services and products by large commercial banks and rural banks like the Indian RRBs could help to cover the big market of small customers and bring about financial inclusion. They had documented instances of 18 banks from 15 countries globally which had in their own contexts had undertaken programmes whereby through downscaling through micro-products and micro-services they had tried to profitably bridge the gap in access to financial services to this population. This included partnership models adopted by Indian private banks. However, there has been an uncritical acceptance therein of the terms of credit, the interest rates charged and the intermediation margins involved. A celebrated example of downscaling and viable operations which has attracted favourable attention globally has been that of Bank Rakyat Indonesia (BRI), which has devised popular savings and loan products for mass coverage. However, BRI's saving product (*simpedes*) carried an interest rate of about 11 per cent while the credit product (*kupedes*) available to the same client carried an interest rate of 44 per cent. In effect, BRI charges an intermediation margin of 33 per cent in lending savings of this clientele to itself through the BRI credit product. While *BRI obviously found that the operations of its micro-banking division were profitable, it was in fact subsidizing its corporate banking channel through profits from micro-banking* – a curious reversal of the cross-subsidization phenomenon (see Seibel, 2005).

It must however be appreciated that though priority sector lending targets implicitly propose a cross-subsidization business model, there does not appear to be a clear implementation of such a model in practice, whereby the RRBs are sustaining their micro-banking business through profits in corporate and other banking activities. *The removal of the interest caps on lending have not been effective beyond a point as RRB lending rates are constrained by interest rates available through commercial and cooperative banking channels and the interest subsidies and subventions provided by the state in various regions and contexts*. An interesting new delivery channel that has come up and holds promise of providing the last mile connectivity, along with its implications for reduced costs to rural poor and unbanked clients, is the BC channel. However, the viability of this channel, especially for the BCs, has yet to be established. Several innovations are being attempted and most bankers are positive on the possibility and viability of this channel. RRB experiments with the BC model in recent years are discussed in greater detail in a subsequent section.

(iii) Recent Performance of RRBs

As observed earlier, within two decades of their existence, the RRBs had become financially weak and Government of India (GoI) initiated recapitalization of the RRBs along with several other policy initiatives to give them operational freedom for enhancing their business opportunities and profitability. Subsequently, in September, 2005, GoI initiated the first phase amalgamation of RRBs, sponsor bank-wise, at state level. By March, 2010, RRBs of the same sponsor banks within a State were amalgamated bringing down their number from 196 to 82. In the second and ongoing phase, starting from October, 2012, geographically contiguous RRBs within a State under different sponsor banks are being amalgamated to have just one RRB in medium-sized and two/three RRBs in large states. During the year 2013-14, 13 RRBs have been amalgamated into 6 new RRBs in 5 States (Chhattisgarh, Uttar Pradesh, Kerala, Karnataka and Haryana). With this, the effective number of RRBs as on 31st March, 2014 stands at 57 playing a significant role in developing agriculture and rural economy. (DFS, 2015)

RRBs generally work in difficult conditions – in semi-urban and rural areas – but with a low ticket size of product and with many regulatory constraints. Besides, RRBs are required to play a particular developmental role with stringent conditions are being placed on them in terms of priority sector lending norms. Thus their profitability is affected by serving scattered and less profitable clientele, with small loan sizes and other service delivery constraints. On the other hand some of the facilities enjoyed by RRBs include the fact that they operated under lower statutory liquidity requirements than other commercial banks, can avail of refinance from NABARD at 3% below the refinance rate[4], and can offer 0.5% higher rate on deposits in the first three years, apart from getting substantial technical and managerial assistance from NABARD and SIDBI.

Table 1: Purpose-wise Outstanding Advances by RRBs

Sr. No.	Purpose	As on 31 March (Rs. in Crores)		
		2012	2013	2014*
	Total loans outstanding	**116385**	**139652**	**159302**
I	**Agriculture (i to iii)**	**63823**	**75200**	**90294**
(a)	Short term loans (crop loans)	46580	55255	68267
(b)	Term loans (for agri and allied)	17244	19406	21952
II	**Non-agriculture (i to iv)**	**52561**	**64452**	**79008**
(a)	Share of agri to total loans o/s	54.84	53.84	56.68
(b)	Share of term loans to total loans o/s	14.81	13.89	13.78
III	**Priority Sector**			
(a)	Priority Sector	95542	111812	130215
(b)	Non-Priority Sector	20843	25266	29087
	Share of Priority Sector (% to total)	82.09	80.06	81.74

* Provisional

Source: DFS (2015)

There has been a steady increase in the total advances outstanding of RRBs over the past three years, with the figure increasing from Rs. 116,000 crores to about Rs. 159,000 crores. Table 1 shows the purpose-wise outstanding advances by Regional Rural Banks (RRB) in India. It will be seen that total advances are over Rs. 159,000 crores, of which the share of agriculture is around 57 per cent. The predominant form of loan to agriculture is the short-term or crop loan, with the share of term loans to agriculture accounting for around 14 per cent. 48 are showing total profit; while 8 have accumulated losses (These are Odisha, Bihar and North Eastern regions, where commercial banks are suffering losses for obvious reasons). Thus RRBs appear have done a wonderful job – all are sustainable, they are all earning profit. At the same time all of them have complied with CRR norms (except for one).

As far as priority sector lending is concerned, the share is consistently over 80 per cent for RRBs as a whole, as statutorily required. However, this figure contains a large number of heads, many of which effectively relate to advances made to groups other than those who are the targets of financial

[4] The revised rate of interest on refinance for investment credit from NABARD for a period of five years for a Regional Rural Bank with effect from 7 January 2014 is 9.70%. The revised rate of interest for refinance for a period of three to five years is 9.90%.

inclusion. Some of these sectors, such as housing, which show potential for growth in future, too reflect the potential for lending to groups not associated with the financial inclusion measures.

As far as balance sheet operations are concerned RRBs maintained stable growth in assets of around 16 per cent during 2013-14. The major sources of growth were borrowings and capital infusion by NABARD and sponsor banks on the liabilities side and loans and advances on the assets side. As per the provisional results, all the 57 RRBs reported profits in 2013-14 with their net profits going up by 18.5 per cent during the year. Net margin (net interest income as per cent of average total assets) also recovered from the previous year (RBI 2014).

Nevertheless, there are several disquieting features regarding the financial operations of RRBs, which have been continuing for the past several years. To begin with, the credit deposit ratio, though it has been increasing steadily, was only 66.6 per cent as on 31 March 2014. This represents a weak performance in the deployment of resources mobilized mainly through rural savings. Thus net loans and advances during 2013-14 were only 47 per cent of total assets. *The RRBs undertook investments in government securities and with the sponsor banks such that the RRBs as a whole were maintaining liquid resources far in excess of the statutory liquid ratio*. Thus, the RRBs were content to place funds with sponsor banks or at government securities at 8 to 8.5 percent p.a. rather than bear the risk and cost of lending to SHGs or for other priority sector purposes at around 11 percent. Interestingly they would simultaneously be availing of refinance from NABARD at around 9.7% p.a.

Thus *a large proportion of the deposits mobilized found their way to the sponsor banks rather than to the people who had placed them with the RRBs for financial intermediation*. While the RRBs generated a small profit, this was achieved through undertaking risk-free deployment of resources with the sponsor banks. For the sponsor banks in turn, this represented easy mobilization of funds for their own activities. This was made possible by the influence of being sponsor bank directors on the boards of the RRB. Thus, *the effect of the 'umbilical cord' relationship referred to earlier between sponsor banks and the RRBs resulted in a particular kind of detrimental relationship, which served to limit the flow of loans to the intended beneficiaries of the RRBs*. It will also be observed that as a result of this investment pattern, recourse to borrowings by the RRBs has also very limited, with even NABARD refinance constituting no more than 20 percent of net loans and advances during 2013-14.

However, NABARD officials assert that RRBs are the true microfinance institutions. Out of a total outstanding of Rs. 1,59,000 crores, Rs. 82,000 crores is the ground level disbursement. 62% of clients are small and marginal farmers: in commercial banks, this percentage is only 39%. RRBs are filling the gaps which commercial banks are not able to cover. However, the question remains whether they gone down market as much as they could have?

5. RRB Achievements under Financial Inclusion Strategy

Measures and products designed to reach the unbanked and the poor have been advocated and consciously implemented for decades. However, in recent years, the starting point of the understanding of term 'financial inclusion' and the related products is associated with the report of the Rangarajan Committee on Financial Inclusion (2008)[5]. Elaborating the thrust of financial inclusion by the RBI, its Deputy Governor states that RBI "are marketing the paradigm of financial inclusion through the bank-led model" (Chakrabarty, 2011).

Thus, the *RBI perception appears to be that financial inclusion is largely a matter related to banks' initiatives rather than the concern of a wider range of players in microfinance covering PACS, MFIs, SHGs, etc*. Consequently the financial inclusion discourse has focused on bank-level products and initiatives and the corresponding targets. The two planks of the commercial banks' involvement in the larger financial inclusion project have been (i) avenues for *outsourcing through different types of agent structures* above; and (ii) the *introduction of IT-based devices and innovations* for low-cost operations and for accounting and MIS. *In fact, the current financial inclusion campaign has been positioned as a kind of successor to the (less than successful) earlier attempts at inclusive finance through RRBs, SHGs, etc.* The approach to RRB reform (of recapitalization and amalgamation) too had been seen as one which was politically pragmatic characterized by an indifference towards the financial inclusion objective of RRB operations (MCril, 2008). Nevertheless it was also observed that despite the apparent importance of commercial banks even in the rural areas however they were neither able nor willing to serve the poorest sections of the population. By comparison, in the credit categories of direct relevance to financial inclusion, RRBs held over a quarter of agricultural credit accounts and over half of all artisan/tiny industry loan accounts with barely 11% respectively in the total credit for these two categories. It also showed that RRBs had a far higher proportion of small loan accounts than other types of banks.

In similar vein, the *Annual Report 2013–14* of RBI (RBI, 2014) has stated that microfinance institutions and small RRBs can certainly help in furthering access to finance. However, *they cannot on their own bridge the gaps. Well-capitalized and robust financial institutions are needed to take up the financial inclusion agenda*.

The Swabhimaan programme launched by the Ministry of Finance, Government of India and the India Banks' Association (IBA) aimed to bring banking within the reach of the masses through brick and mortar branches or through various forms of ICT-based models including through business correspondents (BCs). All public and private sector banks were advised to draw a three-year financial inclusion plan (FIP) starting from April 2010, duly approved by their Board and with related business plans. The spectacular growth numbers in the parameters being tracked by FIPs would appear to suggest that the financial inclusion project is on track in terms of achievements and initiatives aimed at financial inclusion. Banks have made notable, sporadic, efforts at innovation in support in the introduction of technology, financial literacy and other methods of expanding outreach, with RRBs too contributing in equal measure.

[5] The Committee set up by the RBI, states that "the essence of financial inclusion is in trying to ensure that a range of appropriate financial services is available to every individual and enabling them to understand and access those services. Apart from the regular form of financial intermediation, it may include a basic no frills banking account for making and receiving payments, a savings product suited to the pattern of cash flows of a poor household, money transfer facilities, small loans and overdrafts for productive, personal and other purposes, etc." (GoI, 2008).

In this they have been supported by NABARD through the Financial Inclusion Fund (FIF) and the Financial Inclusion Fund (FITF). FIF meets the cost of developmental and promotional interventions and FITF meets the cost of technology adoption for financial inclusion[6]. As on 31 March 2014 cumulative disbursements were Rs. 135.35 crores under the FIF and Rs. 221.55 crores under FITF.

The experience of the FIFs to increase outreach to an increasing large number of villages and unserved areas have fed into the Pradhan Mantri Jan-Dhan Yojana (PMJDY) launched in 2014. According to the PMJDY Mission document, though the banks achieved their targets under the first phase of the Swabhimaan campaign, it had very limited reach and impact. Public Sector Banks (PSBs) including RRBs estimated that by 31 May 2014, out of the 131.4 million rural households which were allocated to them for coverage, about 59.4 million remained uncovered. Comprehensive financial inclusion (FI) under the mission is based on six pillars of achievement with well-defined targets[7].

Table 2: Pradhan Mantri Jan - Dhan Yojana (Accounts Opened As on 15.07.2015)

(All figures in crores)

S.No.		**No. of Accounts**			**No. of Rupay Debit Cards**	**Balance In Accounts**	**% of Zero Balance Accounts**
		Rural	**Urban**	**Total**			
1	Public Sector Banks	7.24	5.98	13.22	12.25	15698.68	50.83
2	Rural Regional Banks	2.57	0.44	3.02	2.19	3493.76	50
3	Private Banks	0.41	0.28	0.69	0.61	1095.93	47.83
	Total	10.21	6.71	16.92	15.05	20288.37	50.59

Disclaimer: Information is based upon the data as submitted by different banks/SLBCs

Source: DFS, GoI.

[6] The major initiatives under *FIF* have been: (i) support to cooperative banks and RRBs for setting up financial literacy centres; (ii) assistance to RRBs for demonstrating banking technology; (iii) support for migration of data of PACS to CBS of cooperative banks; and(iv) financial education and literacy programmes in schools and through common service centres. The major initiatives under *FITF* have been: (i) ICT solutions for RRBs adopting BC/ BF model; (ii) Support for CBS of weak RRBs; (iii) Assistance for CCBs and RRBs for RuPay KCC and RuPay Debit Card and for purchase of additional PoS devices; and (iv) Support to RRBs and cooperative banks for ATM inter-change charges.

[7] The six Pillars are: Under Phase I (up to 15 August 2015): (1) Universal access to banking facilities; (2) Providing basic banking accounts for saving and remittance and RuPay debit card with in-built accident insurance cover of Rs. 1,00,000 and RuPaycard; (3) Financial literacy programme. Under Phase II (15 August 2015–15 August 2018): (4) Overdraft facility of up to Rs. 5,000 after six months of satisfactory saving/credit history. A Credit Guarantee Fund would be created for coverage of defaults in overdraft accounts; (5) Micro-insurance; (6) Unorganized sector pension schemes like Swavalamban.

Table 2 shows RRB achievements under the new financial inclusion strategy. It shows the number of accounts opened under the PMJDY as on 15.07.2015. An indicator of participation in financial inclusion efforts currently is the number of accounts opened under the PMJDY. RRBs opened 3.02 crore accounts under PMJDY, as on 15.07.2015, or nearly 18 per cent of total accounts. Public sector banks opened 13.22 crore accounts and private banks 0.69 crore accounts. RRBs accounted for 2.57 crore accounts in rural areas opened under the PMJDY up to 15.07.2015. This represents over 25 per cent of the total 10.21 crores accounts opened in rural areas. RRBs accounted for nearly Rs. 3,500 crores out of Rs. 20,288 crores of deposits, representing over 17 per cent of the balances in these accounts. The percentage of zero balance accounts out of these newly opened accounts is 50 per cent. RRBs have also opened 440,000 accounts in urban areas.

Public sector banks issued 12.25 crore RuPay debit cards, and private banks 0.61 crore such cards. The number of RuPay debit cards issued by RRBs was 2.19 crores, out of a total number of 15.05 crore such cards issued by all types of banks.

Apart from the accounts opened under PMJDY and savings deposited by RRBs, they have accounted for a large number of initiatives in terms of products offered and infrastructure support provided towards financial inclusion. The range of such products is large and varies from RRB to RRB. It includes various types of deposit accounts and credit/ debit smart cards, insurance products, financial literacy initiatives, Direct/Electronic Benefit Transfers (DBT and EBTs), pensions and various types of loan initiatives such as housing, education. These products have been deployed through various types of outlets, which include brick and mortar branches, Customer Service Point (CSP) outlets, kiosk banking, ultra small branches (USBs), with the help of ATMs and tablet-based micro ATMs and Point of Sale (PoS) devices. The range of products and delivery models for a sample of 15 of the 57 RRBs is illustrated in Appendix 1. This has been updated from information provided during the Inclusive Finance India Award 2014 Process, and from Annual Reports 2013-14 of the respective banks.

As per NABARD sources, in terms of Financial Inclusion, RRBs are playing a major role. All RRBs have migrated to the Core Banking Solution platform – for which NABARD by supporting 28 loss-making banks has played a pivotal role. Also they have, on par with other banks, taken up RTGS and have been supported for deploying ATMs for banking and financial services in North-East region. All RRBs have signed a MoU for implementing Jan Suraksha Yojana and Jeevan Jyoti Yojana. They have issued smart cards of various types and generally have been at the forefront of the financial inclusion measures.

However, this rapid expansion of the banking and financial infrastructure has not been without cost. The opening of new accounts and building the physical and human infrastructure for the financial inclusion mission has been undertaken on a war footing without regard to the initial costs and necessary maintenance costs. The expenditure on opening and servicing over three crore new accounts under the financial inclusion drive – even though half of them may not yet be operational – is quite substantial and goes beyond the call of the RRBs functions and immediate objectives. It would be instructive to examine whether the RRBs load of JDY and financial inclusion efforts proportional to their branch strength, staff strength and total business and capital resources – or have the public sector banks silently shifted this burden over to RRBs? Indeed, *as the RBI Governor has recently stated, and development bankers concur, public sector banks including RRBs should be reimbursed for the expenses incurred in building this new financial infrastructure*.

6. RRBs and the Emerging Architecture for Banking Services in Rural Areas

The Nachiket Mor committee (2013) opined that in the Indian context it would be important to have the regulatory flexibility to approach payments, savings, and credit independently (the Vertically Differentiated Banking Design) and to bring them together when the efficiency gains are high and the other costs are low. Differentiated banks are distinct from universal banks as they function in a niche segment. The differentiation could be on account of capital requirement, scope of activities or area of operations. In fact the UCBs, the PACS, the RRBs and LABs could be considered to be differentiated banks as they operate in localized areas. To tap the unmet demand for financial services, it is felt that it is worth experimenting with new types of institutions for financial inclusion. By stipulating target segments where the financial services should be directed and by indicating the ticket size of the products it is hoped to ensure that the target segment is serviced. The localized operations or restriction on the banks to engage in a particular activity could lead to non-availability of cross-subsidization impacting the viability of such models (Gandhi, 2015). Two types of new entities for which in-principle licences have been granted recently are the payments banks (11 licences) and small finance banks (10 licences). A *question arises how the activities of these entities with overlapping functions and clientele as RRBs would impact on their relevance and viability*.

On the other hand, calling for an inclusive banking structure for India by 2019, Mahajan (2013) has invoked three criteria to judge the success of a banking system i.e. of contributing to (i) inclusion (ii) growth and (iii) stability. He proposed six levels of banking namely – (i) community (ii) region (iii) state (iv) zonal (v) country and (vi) international banking, for which six types of banks would be required. As against a differentiated banking structure, this structure proposed was for universal banks but operating on differing scale of operations. Community banks and small finance banks or Local Area Banks (similar to those recently launched) were proposed for the community and regional levels. The RRBs in turn were candidates for state level banks through the merger of the RRBs, eventually into one state-level bank, to be brought under the Banking Regulation Act, 1959. Similarly, the district central cooperative banks and state cooperative banks would be merged into one state level bank with the Primary Agricultural Societies (PACS) integrated into them. In addition to these, there could be zonal banks, nation-wide banks and global banks. Such a proposal for the RRBs effectively serves to "kick them upstairs" through merger into an entity at the state or even zonal level. However it is not clear as to what purpose it will serve by supplanting the RRBs with their dispersed branch structure reaching out to most villages in the vast majority of districts by other, as yet, less sound institutions[8], at the same time, creating a lack of clarity about fate of the intended clientele. *It would appear that both the proposals for differentiated banking and universal banking*

[8] The RBI Governor does not rule out the failure and folding up of some of the new licencee banks.

adopting a multi-tiered approach have given scant thought to the place of existing RRBs in the proposed financial architecture. As such, they continue to be an entity with great potential but which has not been fully realized, even as new entities are being created.

At the same time many observers believe that there is not much impact likely on the existing banks of the presence of the new players especially as there is vast unmet demand and unserved marked for medium, small-scale and micro loans. Commenting on the emergence of the new types of banks a senior NABARD official says "As long as a person is tied up with one bank for credit, chances are their savings will also go there – it is a natural thing. The lending portfolio is largely taken care by RRBs. Savings and pension/insurance schemes would be routed through RRBs. RRBs will continue to play a strong role in financial inclusion with all the new accounts that have been opened and with insurance schemes and pension schemes coming - all being routed though the banking sector. Payment banks are only supposed to collect deposits, not give any loans. This is one reason why the job of the payment banks will be tougher, in terms of making a huge dent in the deposit market…… Even if the new banks are coming in (e.g. Bandhan, small finance and payment banks), the role of RRBs will not be diluted, though they may have one more competitor in that particular space."

Thus, payments banks in terms of their design and strengths may be able to capture some of the remittances business through various partnership models. However, the core savings and credit and increasingly the insurance business may continue in the hands of the older players. As far as small finance banks are concerned, interestingly they too are poised to be focused away from the clients requiring micro-products which the RRBs too are alleged to have abandoned. As such, *there seems to be potential surge in the availability of financial services to medium scale enterprises and middle income groups which too have probably not received their fair quantum of services over the years*. The definition of microfinance having being further enlarged to include transactions up to Rs. one lakh could mean that such services too could become mainly available to the more bankable entrepreneurial section of the not-so-poor. This may not be of much comfort to the truly excluded families at the "bottom of the pyramid."

On being questioned whether they felt a threat or client overlap with small and payments banks, RRB Chairmen interviewed generally replied that it won't be a challenge as their bank had been a working with rural clients for a long and operated even in the presence of private banks. RRBs, however, are burdened with social schemes, widow pensions, scholarships, etc. and they are not left with any time to focus on other profitable activities.

Some of the RRBs interviewed such as APGBVB have expectations of MUDRA "Bank" as a source of refinance for its operations. Interestingly, MUDRA too covers the space discussed above by proposing to provide funds for on-lending to the microenterprise segment. It seeks to provide refinance to commercial banks, RRBs, small finance banks, cooperative banks and NBFC-MFIs for three types of products for on lending to entrepreneurs[9]. The share of RRBs in total disbursements

[9] These are (i) *Shishu* - covering loans up to Rs. 50,000; (ii) *Kishor* – covering loans above Rs. 50,000 and up to Rs. 5 lakhs and (iii) *Tarun* – covering loans above Rs. 5 lakhs and up to Rs. 10 lakhs. It would be ensured that at least 60 percent of the credit flows would be to Shishu category units. However, according to the latest data for the

for the current years (up to 20 September 2015) is under 13 per cent and total disbursements about 17 per cent. Thus, so far disbursement by RRBs under the smallest size loan size has not been encouraging. As such, even though bottom-of-the-pyramid figures prominently in its vision statement, this agency too appears to be aimed at strengthening the next-to-last segment of the lower half of the population. NABARD officials feel that MUDRA's goals and those of NABARD are aligned. Micro- and medium enterprises need to be supported and that is where MUDRA has to chip in[10]. This would supplement NABARD programmes in DRIP districts, REDP, MEDP and SHG Bank Linkage Programme which have resulted in both employment and empowerment.

In any event, as noted by Nair and Tankha (2015), as part of the new financial inclusion campaign the government will need to substantially strengthen and integrate the institutional architecture, announce breakthrough policies, learn from efficient private sector experiences, and fully leverage technology solutions. Leaving it to the banking infrastructure alone may not yield results. Digitizing the financial inclusion space and bringing in more players to facilitate ease of transactions needs to be encouraged. While small finance banks will help in credit outreach, payments banks will help fill gaps in access to formal payments and remittances system. Business Correspondents will need to be made more viable and strong emphasis on financial literacy is required before the new financial inclusion clients recognize the need and significance of banking.

7. "Jewel in the Crown" or "A Rough Diamond" – Views on the amended RRB Act 2015

The RRBs Amendment Bill, 2014 was passed by the Rajya Sabha on 27 April 2015. Lok Sabha had earlier passed the Bill in December last. The amendment to the Act facilitates the raising the share capital of RRBs from the present ₹5 crore to ₹2,000 crore, infusing capital from other than the present owners to the extent of 49 per cent against the present arrangement of the Centre, States and sponsor banks sharing in the ratio 50:15:35 respectively. According one leading commentator, these changes will pave way for their part privatization and pure commercialization, totally ignoring the very purpose of their birth and the new amendment to the RRBs Act will "surely help to further distance the rural poor, from the access of institutional credit, with great impunity" (Rao 2015).

The Regional Rural Banks (Amendment) Bill, 2014, which got the assent of the Rajya Sabha by voice vote today, seeks to help Regional Rural Banks (RRBs) raise their authorized capital and will enable them to mop up funds from capital market to help strengthen them.

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financial year 2015-16 as on 20 September 2015, disbursements under the Prime Minister's Mudra Yojana (PMMY) by different agencies in respect of Shishu category only total Rs. 4,122 crores out of a total of 23,347 crores, or only about 18 per cent. The current budget provision for MUDRA , however, is only Rs. 3,000 crores.(Source: www.mudra.org.in/pmmy-report.php).

[10] A NABARD CGM has been appointed CEO of MUDRA.

Moving the bill for passage, Minister of State for Finance Jayant Sinha said that the need for amendments has been felt for some time to strengthen the RRBs through private capital and giving them flexibility to strengthen them. He said that there were enough safeguards in the Bill and in no case will the holdings of the Centre and the Sponsor Bank be allowed to go less than 51 per cent (Economic Times, 2015).

When a member of the House called RRBs a 'diamond in the rough' the minister described them as a 'jewel in the crown', although not the entire crown. Given some of the limitations of RRB functioning sponsor bank control and the weak investment portfolio management this seems to be an overstatement. Further, there continue to be misgivings about the fate of RRBs with the infusion of private capital, particularly among bank staff (Box 2) who suggest instead that *a small further dose of capital support from government would have put the RRBs on a sound footing*.

Box 2

Amendment to RRB Act, 2015 – Route to privatization of RRBs?

Opposition to Amendment to the RRB Act has been greater than the voices of its proponents. In addition to some spirited speeches by opposition MPs in Parliament, a web posting by Khan (2015) states:

- As per Section 3 of the RRBs Act, 1976, the Sponsor Banks were supposed to provide manpower and other support including deputed officers in the management for first five years. The five year condition has been withdrawn allowing the sponsor banks to perpetuate their whimsical rule of acting as master and competitor of RRBs.
- In Section 5, the Authorized Capital is being raised from Rs. 5 crores to Rs. 2,000 crores, which is not at all necessary and relevant in the context of RRBs' present state of functions and performance.
- As per section 6, (which prescribes Central Government, State government and Sponsor banks share as 50:15:35), the proposal is to raise share capital from sources other than the Central Government or the State Government or the Sponsor Bank, and to keep the share holding of the Central Government and the Sponsor Banks not less than 51%. It is also proposed that State Governments may or may not continue with ownership of RRBs. This is nothing but a clear cut route to hand over the RRBs to the corporate and the private sector.
- As per Section 9, the amendment is intended to provide for nominees of Private shareholders to the Board of Directors of RRBs according to the size of Private shareholding, ranging from 1 to 3.

These are the major areas of concern not only for the RRB staff but also the democratic minded people interested for rural development and wider coverage of Financial Inclusion. Presently all RRBs are profit making. *By converting accumulated profits into capital base and providing another dose of Rs. 5,000 to Rs.10,000 crores, RRBs will be able to stand on their own feet and even meet the capital risk-adjusted assets ratio of 11.5% as per Basel III norms*. [It may be noted that recapitalization of Public Sector Banks (PSBs) has been a regular feature and in the past 14 years the Government of India may have pumped around Rs. 90,000 crores into the PSBs.] It is understood that all RRB unions came out with a strong protest against the RRB Bill.

Source: Khan (2015)

The provisions of the Act do not seem to be the outcome of a wider consultation which has taken into account all perspectives on this issue. The response to the new Act from among the RRBs visited in connection with this study has been mixed. While KVGB, Dharwar is not much concerned because its weak financial status will not attract any private investor attention, APGVB, Warangal with a CRAR in excess of 14%, is already putting in place a process to seek permissions for an initial public offering. *Going forward there could be a process of differentiation with the best placed RRBs attracting additional capital even as the other less successful ones await a fresh round of capitalization or further round of amalgamation.*

8. Evolution of RRBs - A Holistic Review

Some stakeholders, while noting the many achievements of RRBs, are inclined to have an extremely positive view of the role played by RRBs in priority sector lending, agricultural lending and financial inclusion. At the same time, another set of stakeholders bemoan the fact that RRBs have failed to play a more social role in enabling both the financial and wider areas of development and empowerment of the poor and unbanked population. To assess the relative strength of these positions it may be in order to bring together various thematic questions that have been raised across this paper. It is, for example, necessary to consider the tension between the mission of RRBs and their profitability; questions of cross-subsidization or otherwise across portfolios within the RRBs and how to interpret the RRB demand for a level playing field with commercial banks.

For this a holistic approach in examining the evolution and performance of RRBs is required that goes beyond narrow growth and outreach indicators. Equally, it is necessary not merely to look at RRB aggregates, or even comparative figures for RRBs vis-à-vis other financing agencies such as cooperative banks and commercial banks. Given their original charter, it is equally vital to consider whether RRBs have been able to locate their operations into rural areas such that the poorer sections are able to benefit from them. There is reason to believe that sufficient initiatives have not been taken to bring about such a widening of the customer base, nor has poverty outreach been a theme in the discourse about RRBs, at least since the year 2000 or so. Indeed if poverty targeting was part of the RRB brief it seems to have disappeared.

If we have a closer look at the composition of the portfolio of the RRBs, we find that it is predominantly agricultural, but also devoted to short-term credit. Data has been provided which has shown the limited proportion and scope of investment credit being provided by RRBs. The agricultural borrowers favoured by RRBs probably constitute no more than the next to last segment of the rural population. There is thus reason to believe that landless and non-farm clients have not been the recipients of a fair share of RRB lending, despite the continuation of asset-based credit programmes of the government - as successors to the IRDP in the form of SGSY and now NRLM. The limited flow of credit to the rural underprivileged is further illustrated by the low credit-deposit ratios. Responsible for these ratios is undoubtedly the widely reported phenomenon of RRBs placing deposits with their sponsor banks as risk-free investments instead of lending them to the target clientele. This nexus allows sponsor banks to access low-cost resources through their respective RRBs while at the same time enabling the latter to avoid unprofitable and risky avenues of lending. This type of distortion is an inevitable outcome of the steps taken to capitalize and amalgamate

RRBs - in order to turn around the loss making ones and to create profit-seeking as a central RRB objective. RRB chairpersons without exception are found to be extremely conscious of the need to protect the bottom line. Priority sector lending norms and categories are utilized creatively for achieving both targets and profitability. As such, the achievement of priority sector lending norms by the RRBs needs to be regarded with caution. Indeed, it is estimated that nearly 50% of RRB lending could effectively be for the urban clients.

It would thus seem that in the initial years (1980-90s) RRBs were more closely pursuing their mission, particularly in respect of IRDP lending – a process which results in losses for a large number of RRBs. This process went into reverse subsequently as profitability became the cornerstone of RRB functioning along the lines of commercial banks. This period was also characterized by a decline in the number of small borrower accounts and, importantly, the emergence of microfinance institutions as a channel for retailing loans to the poor clientele. Though SHG numbers in that era were relatively low as compared to those at the present time, NABARD observers also see the amalgamation of RRBs also as a setback to the SHG movement, since RRBs working intensively in a few districts had much closer contact with the rural population. The presence of NABARD staff on the board, and in several cases as RRB chairperson, also served to retain the development focus of RRBs. Thus, the numerical achievements of RRBs nevertheless conceal a phenomenon of what may be described as 'mission drift'. Reinforcing this retreat from poorer clientele is the perception among commercial banks and RRBs that banking with the poor and SHGs is unviable. It would appear that the jury is still out on this question since in the Southern states, some of the more successful, profit-making RRBs are the ones with a large SHG clientele and portfolio. It is felt that as the number of SHG clients of a bank increase, viability ceases to be an issue. Even if catering to SHGs or poor clientele is found to be less than profitable in the initial stages, RRBs could find ways and means to nurture them through this phase. It does not appear that business planning has been undertaken by most RRBs in order to develop and sustain this important clientele, which is part of their mission. It also suggests that principles of cross subsidization and enlightened management and operations have also been largely absent. Otherwise, RRBs could have catered, at more than competitive interest rates, to the clientele of the present-day MFIs, which have loans outstanding of around Rs. 48,852 crores as of March 2015 (Sa-Dhan, 2015). Indeed, RRBs have not even supported MFIs with term loans for their retailing function to this segment. It is only recently that a few MFIs have received RRB loans[11].

The final link in RRB evolution is their clamour for a level playing field with commercial banks. Instead of finding ways and means to serve their intended clientele through innovative products, adoption of the SHG channel or cross-subsidization of operations, the RRBs appear to be more interested in a reduction of the responsibilities assigned to them. The object is to have greater freedom in their operations so as to reduce their priority sector commitments and to access urban clients, and to overall access more profitable banking avenues. It has to be accepted that RRBs have been handicapped by having to maintain parity in pay scales with commercial banks and suffer from other

[11] NABARD (2014) reports RRB loan outstanding to MFIs as of 31 March 2014 as only Rs. 222 crores, including Rs. 117 crores by one RRB to one MFI in Andhra Pradesh!

human resource constraints. Nevertheless, the RRBs of today are scarcely recognizable from the more local banks intended for providing services to families well below the poverty line. It is far from clear how privatization as envisaged under the RRB Act with its objectives of professionalization and efficiency will serve to restore the original mission and clientele of the RRBs. Indeed, the banking architecture as emerging seeks to supplant the RRBs with new types of banks moving them further away from their original objectives through privatization or further amalgamation. If this is realized, the RRBs possibly could soon end up being neither regional nor rural banks.

9. Role and Challenges in Financial Inclusion: RRB Products and Perspectives

This section summarizes the activities of selected RRBs and views of their leadership on their financial inclusion models and challenges. A small sample of four RRBs was contacted in connection with this policy paper. While it is a small sample, it represents a diverse set of RRBs with varying scale of operations and business strategies. Two of the RRBs are drawn from the poorest states viz. Uttar Bihar Grameen Bank and Kashi Gomti Samyut Grameen Bank, Uttar Pradesh and the other two are from the relatively progressive states of Southern India. Table 3 provides a profile of the sample RRBs. It will be seen that while deposits of all RRBs are substantial in keeping with the size of their geographical coverage, the scale of lending operations are significantly higher in the southern states. In the case of the RRB from UP, the levels of loan outstanding are extremely low by comparison. This throws up a range of CD ratios from about 30 per cent to over 116 per cent, as against an all India average of 66 percent or so. Recovery percentages are quite uniform, except in the UP RRB, and all RRBs realize a positive net profit during the current year, as in previous years. This data captures *several of the peculiar features of RRB lending - the low CD ratio for RRBs in regions other than some of the southern states, and the positive net profits regardless of the level of CD ratios and the relative income from loans and other statutory and non-statutory investments - with the latter invariably being extremely high*. This further illustrates the failure of the RRBs to step up the scale of their lending to the priority sector and their target population.

Table 3: Profile of Sample RRBs

Rs. crores (as on 31 March 2014)

	Andhra Pradesh GVB	Karnataka Vikas Grameen Bank	Uttar Bihar Grameen Bank	Kashi Gomti Samyut Grameen Bank (U.P.)	All India (57 RRBs)
Sponsor Bank	SBI	Syndicate Bank	Central Bank of India	Union Bank of India	
No. of districts covered	8	9	18	8	642
No. of branches	704	545	1020	414	19082

No. of Staff	2743	2612	3382	2017	80028
Deposits during FY 2013-14	6791	8629	9343	6930	239494
Loans and Advances (Net) during FY 2013-14	7351	6362	5167	1977	152379
Gross Loan Outstanding					
CD Ratio during FY 2013-14	116.26	74.69	55.3	30.44	66.56
Recovery Percentage	78.21	79.65	88.07	60.34	81.89
Net Profit during FY 2013-14	181	140	65	49	2694

Source: NABARD (2014)

In terms of strategic focus, the four RRBs too display considerable variation. For Andhra Pradesh GVB, SHGs form an important part of the portfolio, constituting around 35 per cent of total lending. This level of involvement in SHGs is unique among the sample RRBs and probably limited only to Andhra Pradesh and Telengana and the certain regions of other southern states. SHGs have been considered to be the ideal partner for RRBs in their effort to reach out the rural population. However, it is only where a systematic and comprehensive promotion programme of SHGs has been carried out by government and/or NGOs, has it been possible for RRBs to reap the benefit of a well organized and captive clientele. The profitability and superior performance of the APGVB also suggests *that a large SHG clientele is not a constraint to profitable operations if other conditions are favourable.*

Box 3

Innovative Product of Uttar Bihar Gramin Bank
Fishery Credit Card:[12]

UBG Bank has launched unique fishery credit card for fishermen community, whose services can be availed through Brick and Mortar Branches. The specifications are:

Purpose/objective	Working capital for fish farming
Eligibility	• Experienced Fisherman • Should own a pond in his name or should possess certified patta • Reside permanently within our service

[12] www.ubgb.in, UBGB HO, Muzaffarpur

	area • Any beneficiary having KCC, GCC, SCC from the branch are not eligible • Age of Beneficiary- Minimum 18 Years, maximum 60 Years • Applicant should not be defaulter of any bank or Financial Institution
Loan Amount	Rs. 25, 000 per acre, Maximum Rs. 25,000
Validity of card	5 years
Margin	Not applicable
Interest rate	11.50% (subject to change), Applicable Half Yearly
Security	Primary Security: Hypothecation of property purchased by using Bank loan; Collateral Security Not Mandatory

Source: UBGB and Access-Assist Bihar team

Uttar Bihar Grameen Bank, one of the largest RRBs in terms of branches and area covered has been reliant less on SHG operations than to high degree of innovation in respect of BC operations. IT has also developed a host of innovative cards for different sections of its clientele, MUDRA Card, Fisheries card (Box 3 above) etc. and been very active in financial literacy in a relatively backward region. For the UBGB, it is operating of a strong Business Correspondent Centre with a viable business model, through which it is hoped to engage BCs in providing saving and lending products. Box 4 below illustrates the working of the Sunehra Sapna Scheme of the UBGB. It is expected that there would be a customer base of 9 million customers served by branches and 5 million customers serviced by BCs, who will provide the full bouquet of basic banking products and services.

Box 4

BC model of UBGB – Sunahara Sapna Kendras and Samriddhi 400

Uttar Bihar Gramin Bank (UBGB) came into existence on 1 May, 2008 after amalgamating 8 kshetriya gramin banks, all sponsored by Central Bank of India and located in northern Part of Bihar. Through its 4,461 (1031 Branch + 3430 BC centres) banking outlets, the bank is charting a course to lead holistic development of villages of North Bihar – all classified as financially excluded districts by Rangarajan Committee, GoI (2008).

Its BC model is a low cost model and is self-sustainable for the high volume and low value transactions of the bank. UBGB's Business Correspondent Centre, which is named 'Sunahara Sapna Kendra', can achieve break-even with around Rs 12.25 lakh of deposits in Savings Bank accounts, whereas for a conventional bank branch it is around Rs 3 crore of business. This illustrates the viability, potential and importance of BCs for the bank.

Samriddhi 400 is a programme of the Bank to ensure that every Bank Mitra (BC) earns a minimum average monthly income of Rs 10,000. UBGB gives a commission of Rs 200 per loan account to the BC (Rs. 100 at the time of opening and Rs. 100 at the time of closing). So if a BC opens and maintains 400 loan accounts at the Sunahara Sapna Kendra, he can earn Rs 80,000 as commission in addition to fixed minimum remuneration of Rs 42,000, which works out to an average of more than Rs 10,000 per month. Servicing 400 loan accounts in not a difficult task since the Sub Service Area is unbanked - having 1,500 households - mostly of agriculturists or micro entrepreneurs and the bank has two loan products for micro enterprises – agricultural or non-farm.

Products on offer through BC operations:

- Basic Savings Bank Account (Gramin Bachat Khata):
- SB account with inbuilt overdraft facility: Smart Flexi Recurring Term Deposit.
- Micro KCC (Production credit to agriculturists up to Rs 25,000.
- Micro GCC (Credit for Non-Farm activities up to Rs. 10,000.
- Micro pension and micro insurance

Inter-operability between all BCs helps customers in getting banking facilities at any place in the UBGB command area.

Source: UBGB and Access-Assist Bihar team

Kashi Gomti Samyut Grameen Bank has a comparatively small SHG portfolio, on account of the absence of strong NGOs and SHG federations in east Uttar Pradesh, and the limited interest in SHGs except for receiving subsidy. However, it has taken the national lead in the introduction of IT-based applications. It was the first grameen bank to get the Skoch Award for financial inclusion and Employment generation by introducing the solar micro grid and integrated (light and stove) energy system. It was also the first grameen bank to become 100 per cent on the CBS platform and to start the inter-operable ATM facility and to introduce the fully indigenous RuPay ATM cards; and to introduce mobile banking. It has thus been at the cutting edge of various technological innovations in the RRBs. However, as can be seen in terms of performance, its loans and advances are only a fraction of deposits, which suggests that it has not utilized its full potential in the delivery of financial services.

KVGB Dharwad too has a limited exposure to SHG, constituting only 5 per cent of its total portfolio. At least two of the RRBs UBGB and KVGB appear to have a philosophy of *first lending and then mobilizing deposits*, contrary to the wisdom of SHGs as well as more recent initiatives related to the PMJDY. In the case of KVGB, the pygmy deposit scheme (PDS) of Syndicate Bank, which used to rely on doorstep services has been enhanced under the Vikas Jan Shakti (VJS) into a scheme for daily collection of loan repayments and savings deposits. The BC channel too has incorporated this dual function in the interest of BC income and viability. This innovative financial inclusion scheme is illustrated in Box 5.

Box 5

KVGB Vikas Jana Shakti - Daily doorstep collection of recoveries and savings

Why do villagers opt for MFIs who disburse loans at around 24% on an average when banks provide loans at 11% -12%? This question led KVGB to conceptualize and extend services to villagers in their operational area as a substitute for MFI loans under the *Vikas Jansakti Scheme (VJS)* in Dharwad and other districts of north Karnataka.

The scheme is being implemented through NBA (Nirantar Deposit Agents). These agents were part of the recurring deposit scheme of the Syndicate Bank (sponsor bank of KVGB) – the pygmy deposit scheme of yesteryears. NDA scheme was earlier only a deposit scheme, now it has become a loan-linked deposit scheme. VJS started conducting *gram sabhas* to promote the scheme and to identify potential beneficiaries. The *gram sabhas* looked at aspects such as the purpose for taking the loans with a focus on how the customer was going to repay. The objective was to disburse loans for Income Generation Activities but sometimes people used loans for consumption or to repay previous debts. The money income in the villages is not much of a concern since every person in the village earns around Rs. 150-200 per day. Thus many could start their own ventures in dairying, agriculture-related activities, retail, etc. with the help of VJS loans.

VJS also sponsors trainings for people wherever needed. Therefore apart from providing finance at the doorstep, VJS also provides knowledge and training to borrowers. Its logo embodies the four main objectives of the program – financial services, insurance, social security and extension facilities (FISE).

VJS loans are being provided at the rate of 14.5% p.a. Customers first start with a saving account to avail loans; we are in fact providing individual beneficiaries with loan facilities ranging up to Rs. 50,000 without any collateral. From the day after loan disbursement, an agent goes to the villages and collects the installment amounts every single day. The agent visiting the borrowers everyday also provides borrowers with the opportunity to open an account and start saving. This initiative on financial inclusion was started in 2013 has been able to finance 45,000 beneficiaries till date from 9 districts. Portfolio amount disbursed has been more than Rs. 300 cr. Today the outstanding portfolio is 260 cr. with a recovery percentage of 99%.

The VJS initiative focuses mostly on financing individuals. However, under certain cases of collective ventures, group financing is also encouraged. A lot of freedom in decision-making is given to the branch financer on whether s/he wants to promote SHGs or individual finance. The main factor that is considered is that borrowers should have a genuine intention to start a career, venture, etc.

At present there are 800 NDAs and 700 BCs. BCs are appointed as per government guidelines according to which they carry out banking activities. Like BCs, who undertake similar functions, NDA agents are also provided with hand-held machines, where they get updates about their transactions. BCs get commission on transaction basis and similarly the NDA agents are also paid a minimum of Rs. 750 per month + Rs. 250 as conveyance and 2% commission for the collections against loans provided.

Source: Interview with Chairman, KVGB

Thus the RRBs involved are all engaged in their own innovative efforts at financial inclusion. They note that financial inclusion is not new and has always been a part of bank's work and objectives. Apart from standard savings and credit products they have also introduced life and health and livestock insurance products developed by their own sponsor banks or in partner with other service providers. It is inevitable that their approach and also invariably the technology adopted and innovations are influenced by the views and strengths of the sponsor branch. Thus the RRB of a bank which introduced doorstep banking has taken the lead with that approach to financial inclusion. Where technology has been a strength it ahs similarly been reflected in multiple products developed. Where large scale lending operations involving SHGs are a sponsor bank's hallmark, these are carried over to the RRB's approach. Other selected perspectives emerging from discussions from Chairpersons of the selected banks are given below.

(i) Karnataka Vikas Gramin Bank, Karnataka

The bank's programmes, though seeking to be inclusive are directed at individual clients. The bank realized that over time that the concept of peer pressure was not working any more in the case of SHGs. There were numerous instances where people kept saying that one person has not paid so the other person also would not pay. The collective sense of repayment was gradually diminishing leading to "co-operative default". Therefore the bank mostly finances individuals. However under certain cases of collective venture it is encouraging financing groups also. A lot of freedom in decision-making is given to the branch manager as to whether he wants to promote SHGs or undertake individual finance. Overall, the bank does not seek to cater to SHGs directly as its clients in view of some of the experiences of the past described above. However, it is not averse to the idea of BCs serving SHGs just like individual clients. *One of the innovations in village level banking is to organize gram sabhas which help to identify potential individuals for loans.*

Thus, a second scheme called *gram sahayoga* has also been started. The bank covers 2600 villages and has around 3000 staff strength. Under the scheme each staff member has to adopt one village for its overall development. This was done before the launch of Sansad Adarsh Gram Yojana by the Modi government. The sahayoga model checks if the activities of the bank branches are carried being out properly. Once in 15 days the staff visits the village in the presence of people from nearby branches as well. Subsequently gram sabhas are conducted to check the bank branch's working as well as raise issues to be taken up with the district administration.

The bank has taken up several other products and initiatives for financial inclusion. It has tied up with LIC for life insurance for its clients. The New India Insurance has quoted the lowest price at Rs. 490, enabling it to provide all VJS customers with health insurance to the extent of Rs. 50,000. They have incorporated these schemes into the Jeevan Jyoti scheme which is very popular with the rural population. Of 4 lakh accounts opened under JDY it has been possible to canvas more than 2 lakh policies. An exciting innovation is the introduction of a financial literacy helpline for its clients which is due to start shortly. Details of this service are provided in Box 6.

Box 6

Financial Literacy Helpline - KVGB

KVGB have tied up with *indiamoney.com* to promote a helpline number on financial literacy. People just have to give a missed call and they will immediately receive a return call. During the call some details will be asked based on which they will be categorized in terms (4 categories) of their financial literacy. Some 30 modules have been prepared with already recorded messages that too in the form of celebrity voices to make it more exciting. So once initial call is made they receive a call back in which recorded messages will be delivered as per their convenience (on schemes, Jeevan Jyoti, APY, JDY, VJS, etc.). This program was planned for launch in June 2015.

This service will provide information beyond what the NDA agents can explain. The best part is in between these recorded voice messages, personal records are also kept for further follow-up. The reach of the FLCs is limited and are somehow not able to reach out to a large number of people. The FLCs are stationed at one place with rare village visits coupled with no concrete feedback mechanism. Through the module scheme a holistic approach to financial literacy is being adopted with the possibility of continued interaction (given the saved call records). Further, once a lead is received from a person it is possible to provide help according to the scheme required by them (loan, insurance, etc.)

Source: KVGB

Regarding competition from small finance and payment banks the bank admits that competition will be there but will not be able to match the RRB because of its proximity to nearly all villages having more than 3000 population since villagers will prefer going to the banks personally for their transactions as far as possible. With kiosk machines spot transactions can also be printed in the passbook. The bank also plans to start remittance services and wants to capture the market before the advent of the new entities.

The bank fears high risk due to concentration of its portfolio in agricultural credit. However, attempts are being made to diversify the portfolio within the priority sector towards horticulture, housing and education. With the decline in concessional refinance from NABARD there liquidity problems also. In addition, there are risks due to natural calamities and political factors. However, it has a harmonious relationship with its sponsor in dealing its issues. As far as technology is concerned, having grown in size the bank wants to develop its own capabilities and not depend on the sponsor banks. So technologically it wants to become self-reliant and is slowly moving away from sponsor bank and developing its own capabilities and expertise.

As regards the new amendment on the RRB act and its provisions the bank feels that in the case of most RRBs the balance sheet it might not be attractive & the asset quality might not be impressive as it is purely agriculture and priority sector advances which private players would consider to be risky.

Regarding credit bureau usage, the problem is that in RRBs data acceptance is very low, only 40% is accepted. Most farmers do not have PAN numbers, without some uniqueness their data is not accepted. Once the AADHAR number is in place it will be possible.

(ii) APGVB, Andhra Pradesh and Telengana

The bank opened over 20 lakh accounts under PMJDY but these being zero balance accounts have not been transacted much by the people. The biggest drawback for the RRBs is *staff crunch and capacity building*. Even at times to open a branch it becomes difficult due to the *high attrition rate*. Lateral recruitment at the middle level is also an issue. BCs have been engaged in providing Direct Benefit Transfers in the state. The bank is optimistic about the BC model as it might be helpful to the RRBs to function but it requires a lot of standardization and regularization. Operations of the BC also have to be properly maintained. Having 1800 BCs, the bank has appointed Nodal Officers in each region which each of them monitoring 120-130 BCs by looking into transactions, amounts handled and generally making them viable.

The SHG structure was considered to useful but one which was not being utilized properly. Nevertheless, even now the NPA was less than 1.5 per cent. *The bank is looking for more BCs to stabilize the SHG system. This, in effect involves a different type of bank-SHG linkage relationship – through the BC as intermediary - as in the case of individual clients*. The bank is also working on retail assistance to the SME sector also in order to reach out to more people. So that more people can be reached out to, expertise can also be created.

APGVB too has been able to reach out to the masses through conducting *gram sabhas*. That has helped the banks in mobilization of the deposits, etc and to connect to people through the process. This has been a very useful mechanism. To introduce new products the bank is looking at products designed by other organizations and tried to modify also a few. But all products are the same and there is hardly any variation. Like SBI they have introduced equated installments on repayments. In case of deposits they have wanted a product where depositors can simultaneously get some income in the interim period; however, despite SBI's contribution technology has been a constraint.

The bank has been engaged in providing insurance services and has generates Rs. 11 crores as premium with 4 lakh beneficiaries, the first among RRBs. Here too technology is a constraint. The bank wanted to introduce mobile banking by June 2015 since it is believed to be the cheapest and most efficient mode. SBI has given approved the service provider and they are only waiting for RBI's permission to enter into an agreement.

As regarding use of credit bureau the bank is sharing/uploading information. However, sharing of SHG individual account details have yet to be initiated.

The bank feels several good RRBs will be benefited by the new amendment to the RRB Act. It is itself well place with Return on Assets of 1.67, CRAR of 13.46% and NPAs of only 3.29%. The bank is look forward excitedly to raise capital through splitting Rs. 100 shares into Rs. 10 in order to approach the capital market for Rs. 500-600 crores. However, RBI permission is yet to be obtained.

(iii) Uttar Bihar Gramin Bank, Bihar

The bank feels that in Bihar priority sector lending which targets large numbers of small value enterprises is one of the important areas to achieve financial inclusion and banks are on the right track. Financial Inclusion is not new for banks. It is being done since 2008 when no frill accounts were introduced. Under JDY, this has been given a more focused approach, with the objective of preventing leakages in doles, subsidies and grants. So far UBGB has opened around 23 lakh accounts under JDY and nearly 33% of accounts are active. In coming days all the accounts will be active and operational.

The command area of UBGB comprises of 18 districts having population of more than 5.65 crores. Its headquarters is at Muzaffarpur and there are 20 Regional offices to have proper control over 1, 031 branches. The bank represents 40% of the entire branch network of commercial banks in 18 districts and has a crucial role to play in the economic development of the region. Through its 4, 461 (1031 Branch + 3430 BC centre) banking outlets, the bank is charting a course to lead holistic development of villages of North Bihar by proactive in all development initiatives of the Government, NGOs, private entities, individuals, and on its own. Using BCs as described above, the bank is targeting average monthly earning of not less than Rs 10,000 for its BCs, whom it considers as members of its extended family. It represents probably the most focused attempt to integrate BCs within the bank's functioning.

The bank has discussed with six insurance companies for developing a micro insurance policy which is tailor-made for its clients which is yet to be finalized. Regarding NPS Lite, the bank has applied for aggregator license from PFRDA and has plans in the radar for micro mutual fund as well. The delivery channel for para-banking products in paperless mode would be the BC Centres or Sunahara Sapna Kendras. UBGB is not looking for profit in providing para-banking services to customers. IT plans to act true to its vision of taking leadership for bringing about a developmental revolution in its command area as encapsulated in 'Gram Chetna – Going Beyond Banking'.

(iv) Kashi Gomti Samyut Bank, U.P.

The bank has a record opening of new accounts under the JDY but 60%-70% were in zero balance status as targets had to be fulfilled but now 42% of zero balance accounts are left and more than 50 % are active. The RRB's presence in rural areas is greater than that of commercial banks so more villages could be approached. Radio and other promotional methods were used to make the people aware of the schemes.

Business correspondent model has recently been launched by the bank and now 800 BCs are working for it. Kashi Gomti Samyut bank has been closely working with the Vikas Mitras or BCs, and provides them incentive of Rs. 5 per account. It is felt that SHGs in eastern UP work only for the subsidy. Interest subvention in place of capital subsidy is appreciated. Interest subvention will actually make SHGs them more serious towards their work. Banks see SHGs as clients to finance, but in eastern UP SHG federations are not present like in western UP. In Chandauli, Jaunpur and

Bhadohi district SHGs are working well. NRLM and RGMVP have worked a lot to promote SHG bank linkage.

The bank's portfolio presently only consists of 4-5 % SHG component and it is mainly directed at agriculture - around 45 %. The urban exposure is 20 % and rural 80 %. It has recorded very limited coverage and despite the high level of technological experimentation reported.

Union bank is the sponsored bank of Kashi Gomti Samyut bank. The support of the sponsor bank in has been extraordinary in introduction of technology, training & capacity building. Rupay card was first introduced in India by Kashi Gomti Samyut Bank as also a host of other technology-based innovations that have been documented and rewarded at several forums.

The bank leadership does not have any expectations from the amendment to the RRB Act. Nor does it feel that RRBs should be treated as commercial banks and cater to the elite, instead only be focused on the less privileged sections. For this purpose it feels that the *need is to have a Rashtriya Grameen Bank which brings all the RRBs together and operates in a more focused manner*.

10. RRBs and the Business Correspondent Channel

Microsave (2014), the leading researcher of BC agent networks, provided evidence on the status of agent networks in India and recommendations for the future. Piecing together the evidence from government data and its own studies, it showed that the true reach and quality of the branch and agent network of banks was poor and characterized by very low levels of activity. Microsave field research further showed that a large number of BC agents complained about lack of support for their activities, the low revenue from their operations and the recoveries of operating expenses by the network managers regardless of the level of the revenue generation. However, where the BC models were focused on anchor products such as remittances urban, and even rural, BC networks were becoming stable and even profitable as was the case where agents enabled a wider mix of products (credit services, involving loans as well as recoveries, along with savings) and received support from the bank branch.

(a) Findings of NABARD Study on Viability of BCs of RRBs

As already observed, out of four RRBs visited three had already made considerable headway in BC operations and one was relatively new in its implementation. As can be seen from the foregoing section, the RRBs have been active in deploying BCs in their areas of operation. The various models include: (i) BCs operating out of BC Centres (ii) BCs active in lending apart from savings operations and (iii) BC structures with nodal officers in each region.

Nevertheless, though the long-term outlook is positive, doubts about the viability of BCs remain. This is evident from the findings of the study below. NABARD conducted a study of 23 RRBs to establish the viability of the BCs being deployed by the RRBs. The results of the study given in Box 7 report a familiar story of limited incomes and products outlined above. Nevertheless, the RRBs found it to be a potentially viable channel once a few problem areas had been attended and a wider range of products and responsibilities were introduced. The opportunities provided by the recent insurance and social security schemes and the lower limit for BC remuneration would act as a stimulus to them.

Box 7

Study on Viability of BCs in Regional Rural Banks

23 RRBs were covered based on the number of BC transactions undertaken by them up to 31 December 2013. The study was conducted in during April–May 2014.

Selected Findings:

- For almost 50 per cent of the CSPs interviewed, BC operations were the main source of income.
- In 60 per cent of the cases, the CSPs were earning in the range of Rs. 1,500 to Rs. 3,000 per month.
- The transaction charges paid to the CSPs were in the range of Re. 1 to Rs. 2 for deposit or withdrawal transactions and Rs. 5 to Rs. 15 for opening an account.
- All the CSPs were offering opening of savings bank account, deposit and withdrawal transactions.
- However, only one RRB was providing credit products like KCCs through CSPs as also microinsurance.
- Customers of the bank were appreciative of doorstep banking services provided by CSPs. There was a demand for more services to be offered through CSPs especially credit products.

Issues highlighted by the various stakeholders:

- Limited number of products being offered through CSPs and low per transaction commission provided
- Connectivity issues and Lack of interoperability of systems and devices
- Low per day cash limit of CSPs
- Lack of capacity building of branch managers and training to BCs on banking aspects
- Lack of financial literacy and awareness

It was concluded that the BC channel was viable provided banks were ready to invest in it. The cost of transactions was extremely low when compared to transactions at branch, ATM, etc.

Source: NABARD (2014)

Besides, in a rapidly changing environment with new technological applications and regulatory provisions being introduced at great speed and institutional innovation also being attempted the BC space is set fair to achieve viability. Great hope rests on the ability to introduce mobile applications which will considerably cut down costs of operations and add to volumes.

(ii) SHG members as BC Agents - model of GIZ and Gramin Bank of Aryavart

One of the issues and challenges in respect of financial inclusion and the BC model is its relationship with existing structures of financial services delivery. As has been seen, SHGs are long-standing clients of RRBs, even though their importance in the RRB portfolio is quite variable. In fact, it is held in some quarters that self-help groups (SHGs) with their knowledge of the village families and their exposure to financial literacy and money management can be good candidates as BCs. However, SHGs have not found favour in circulars spelling out the approved list of business correspondents. However, during the past several years, SHG members have been approved to act as business correspondents. Taking advantage of this, the Rural Finance Institutions Programme (RFIP) of GIZ has engaged in two pilot projects to test the potential of SHG members functioning as bank agents to offer banking services at the doorstep of the villagers, particularly to women and poor households. The first pilot project rolled out in May 2013 with Grameen Bank of Aryavart (GBA) in Unnao district of Uttar Pradesh. A second pilot project was started with guidance from NABARD in Indore district of Madhya Pradesh in May 2014, with Narmada Jhabua Grameen Bank (NJGB). In both projects, RRBs have partnered with a local federation, corporate BC and a technology service provider. SHG members are appointed as BC agents or *bank sakhis.* The *bank sakhis* are paid a commission by the bank for different services, and supported by the other stakeholders. The progress of the Unnao project as on 31 May 2015 is give as under:

Table 4: GBA *Bank Sakhi* Pilot Project, Unnao District

Progress as on 31 May 2015

No. of *bank sakhis* appointed	50	No. of clients with bank accounts opened by *bank sakhis*	20,208
No. of *bank sakhis* operational for more than 3 months	49	Total No. of transactions (deposits and withdrawals cumulative)	265,335
No. of villages reached by *bank sakhis*	174	Total value of transactions (deposits and withdrawals cumulative)	Rs. 371,51,922

Source: GIZ (2015)

Each *sakhi* is allocated one gram panchayat covering 4-5 villages and responsible for the usual BC operations of delivering banking services on behalf of the bank. They are also members of a block-level SHG federation promoted by Rajiv Gandhi Mahila Vikas Pariyojana (RGMVP). *Bank sakhis* have also been successful in creating awareness about solar home lighting systems and their benefits among community members on behalf of the bank. The Bank sakhis thus have additional sources of income from promotion of solar energy, with the agents receiving an incentive from the supplier of lighting systems financed with a bank loan.

In addition, dual authentication technology permits the *bank sakhis* to also conduct *transactions for the SHG* and its members, through the micro-ATM at the meeting place itself. This leads to better transparency at the group level and is a way forward towards digitization of SHG-based transactions and the effective monitoring of SHGs.

However, some structural and operational features are to be dealt with in this BC model, including the issue of liability, whether it rests with the SHG member or the super BC (SHG federation). It has been reported that the expected remuneration levels of women functionaries engaged as *bank sakhis* are comparatively low and their motivation could be partly derived from non-monetary factors. This may not be a very sound basis for the bank-BC relationship. As such, the project may not be readily replicable in different areas and contexts. Efforts and models for the involvement of SHGs and their members in the new Financial Inclusion Strategy by RRBs and other agencies will need to continue.

11. RRBs: Outstanding Issues and Policy Imperatives

(i) Outstanding issues:

It is clear from the foregoing analysis that there remain several outstanding issues in relation to the role and performance of RRBs, particularly in respect of financial inclusion policy and the emerging financial architecture. Reflecting on the observations of RBI's Internal Working Group 2005, most of the key factors identified - short term lending to agriculture with a high co-variant risk; the focus on small customers constraining profitability; the weak capital base and organisational structure discouraging large-scale operations; poor financial skills and human resources as a constraint on efficiency; and conflict of business interests with sponsor banks - have been responsible for a relatively low credit deposit ratio and neglect of lending to the weaker sections of the rural population.

The following major issues need to be addressed:

1. To begin with, the *precise role of RRBs* in the financial architecture has to be defined along with an appropriate business model. Are RRBs to scale-up through privatisation and further rounds of amalgamation to be moved up in the financial value chain? If so, how is that going to affect their ability to serve their original mandate? How are the emerging entities such as small banks, MUDRA and payment banks positioned in relation to RRBs, now and in the future?

2. The *viability of RRBs* – Is there a need for a modified view to implement strategies of cross-subsidization and even more ambitious and alternative accounting frame that takes into account their special charter and area of operations? Overall feedback from RRBs is that they would prefer to have a level playing field in order to be able to complete with commercial banks and deliver according to standard performance criteria. From the point of view of sustainability RRBs want to be allowed to expand their non-priority sector portfolio as well in view of the asset concentration risk and other low profitability. However, RBI does not allow them to open branches in urban areas.

3. *Investment issues* – As has been seen, RRBs, instead of focusing on lending are content to place funds mobilized through deposits in government and PSU bonds and with their sponsor banks, often in excess of the statutory liquidity ratio. As a result RRBs' investments in government securities and PSU bonds and debentures have increased while they have been hesitant to augment their loan portfolios. What incentives can be created to break this phenomenon and the dependence on sponsorship banks for off-take of the RRBs' investment funds?

4. *Human Resource Issues* – The constant refrain in both the literature as well as from the field is about the two-fold effect of the HR factor, of how the high wage structures are determined by commercial bank rates and skills and nature of personnel are not appropriate for the banking business undertaken by RRBs.

5. *Technology* – A host of technological applications await introduction in the banking system, and with the inevitable time lag, with the RRBs. A case in point is the RBI clearance for mobile applications to be used by RRBs.

6. Finally, regarding *Financial Inclusion*, while a host of measures and products have been introduced by the different RRBs given their strengths and sponsor bank initiatives, an important client has been given short shrift in the quest for profitability. *SHGs constitute a natural partner for RRBs badly in need of sustenance*. However, what may be required is the *development of a critical mass of SHGs in each area, which permits large-scale operations and economies of scale*. For this, the support of NRLM and NABARD, as part of a multi-pronged effort could provide the answer. It could also lead on to further scaling up of financial services, as larger livelihoods efforts are undertaken. Related to financial inclusion is another important area - that of the BC model, the viability of which is still open to question and renewed efforts need to be made to generate an appropriate business model.

(ii) Concerns related to Sponsor Banks, RBI and NABARD policy

Some of the more specific concerns emerging from discussions with RRBs and other stakeholders are:

1. Refinance from NABARD - As observed earlier, the rate at which refinance is provided to the RRBs is over 9 per cent per annum. Given the interest rate and cost structure, RRBs feel that this is unduly high and that NABARD is making profits by squeezing them. One RRB was required to draw refinance of Rs. 200 crores at 9.15 per cent per annum even when it was not required.

2. Issues with sponsor banks and RRBs:

i. Many RRBs have ATM costs. When its clients transact at a different ATM Rs. 20 is deducted. In some RRBs, the costs are being met by them, whereas in others, the sponsor banks are bearing this cost. However, the sponsor bank is not agreeing to waive the ATM cost for some RRBs.
ii. Publicity and commercials have to be whetted and confirmed by the sponsor bank, which results in delays in availing of the services.
iii. Technology support is very important but the Reserve Bank of India is not giving the RRBs the freedom to engage in mobile banking and internet banking even though these are much cheaper modes of service delivery. This is despite the fact that all the RRBs have already implemented the core banking solution (CBS).
iv. Regulatory norms for BCs – RRBs were generally satisfied with the regulatory norms for the BCs. However, there was a suggestion to recognize the BCs as a separate cadre in banking services – somewhere around the clerical grade – with separate service regulations for them. This could, however, result in the loss of flexibility available in outsourcing of operations.
v. RBI should incentivize inclusion by reducing the SLR requirements, by keeping them lower for more inclusive banks. This could be measured by the average deposit and average loan size ratio. The smaller these are, the more inclusive is likely to be, and a community development bank could have a smaller SLR than a bank with a larger average loan size and so on. The 2.5 lakh BCs and 150,000 Common Service Centres (CSCs) should be fully utilized to provide all financial services for low-ticket users. This would be the precursor for the next cost-cutting revolution, the ushering of m-money and the elimination of currency (Mahajan, 2013).
vi. Members of an UNDP-Discussion Group highlighted the need for RRBs to invest in the financial literacy of rural women, promoting SHGs and providing capacity building support for promotion of enterprises and income generation activities. In this way, RRBs could provide critical contribution to livelihood strengthening of the rural poor by exploring funds from the National Rural Livelihoods Mission (NRLM) and NABARD (UNDP, 2012).
vii. Whenever there is any technology upgradation, it is first implemented for the sponsor banks and then comes to the RRBs. It has its advantages as well, as the flaws are removed before coming to the rural bank set-up.
viii. RRBs are reliant on sponsor banks for treasury management advice, and though delays happen, it is a useful area of support.
ix. RRBs generally cannot work in rural areas with fixed branch timings and are often swamped with a mountain of paperwork related to small transactions. Thus, the human resource constraint too is a major issue. Staffing of RRB branches needs to be based on requirement and business demand and not on the basis of mathematics (e. g. one branch requires four people as defined in guidelines).

3. RBI regulation – The mandate of the RRBs is to work for the priority sector. But, the norms for judging a bank (for e.g. NPA norms) are the same for all banks. However, RRBs are

required to direct 60 per cent of their advances to the priority sector, while for commercial banks it is only 40 per cent. Besides, RRBs cannot take any legal action on recoveries. No collateral security is retained for loans by RRBs whereas in commercial banks, no loan can be sanctioned without collateral security. While giving concession to borrowers under one time settlements for recovery of loans, in case of commercial and public sector banks they can chose to recover only the principal amount and waive off the entire interest. However, RRBs are not powerful enough to do so. This inequity needs to be addressed.

4. Need for technology – There is an urgent need for introduction of mobile technology and internet banking by RBI and the sponsor banks.
5. RRB Investments and Sponsor Bank Control: Where RRBs are still being directed to the lower profitability business/remote areas by the parent banks, then how is the viability issue to be resolved? How can they meet the same profitability standards as other scheduled banks? RRBs are not being allowed to lend or to invest anywhere other than keeping the money in sponsor bank, even if they get better rate of interest somewhere else. One simple policy decision by RBI could break this nexus. RBI could specify that money kept by any rural bank with its sponsor bank will not be treated as a part of SLR (just like they did with DCCB and SCBs). RRBs will get the freedom to invest it somewhere else, at a competitive rate.

As Shahji K.V., Chairman Kerala Grameen Bank has observed RBI regulation will need to be more innovative, otherwise the RBI will be behind the curve of the real economy. The need is to draw the untapped potential of the poor into the marketplace and to help rural banks, cooperative banks and commercial banks, a large number of rural credit bureaus on a district-wise basis need to be created so as to track all money transactions in a district. This could be easily created using the Financial Inclusion Technology Fund (FITF), managed by NABARD (Source: Inclusion, 2015). They are supposed to use the credit rating system but penetration will take some time to stabilize since the rural credit data of borrowers needs to be captured. This combined with branches being able to respond creatively to client needs through exercise of pricing freedom to factor in operational and risk costs could help RRBs to do profitable business that meets ground level needs. Within this framework, they need sustained policy support from the sponsor bank, RBI and NABARD in the areas outlined above.

12. Concluding Observations

Summing up, while the achievements of RRBs in terms of rural outreach and financial inclusion, especially as compared to other financing agencies, are impressive there remains divided opinion on their future role for many reasons. As seen for the foregoing discussion, they have not fully utilized their potential, especially in the area of credit disbursement. Besides, their role in the emerging architecture and their viability continue to be issues of major concern, for which specific steps need to be taken and incentives created, such that they are able to fulfill their mandated role. The creation of a range of banking entities appears to crowd into the space presently being occupied by the RRBs. Initiatives such as the amendment to the RRB Act, that seek to create a role for private players in

RRB ownership appear to have been pushed through without a wider consultation and consideration of alternative options. Calls for further amalgamation of RRBs to the state level also can contribute to further distancing them from their original mandate. More specifically, both at the level of RBI and NABARD on the one hand, and the sponsor banks on the other, a range of policy and regulatory norms and measures have been be identified that need to be considered to better direct the RRBs in the service of the relatively poor and unbanked clients. In fact, especially with the advent of more players in the space for providing financial services to SMEs, it is an opportune moment for the RRBs to re-examine the place of the poorest segment in their operations and lending portfolio. Several elements of the new financial inclusion thrust offer both the methodology and the institutional innovation to forge partnerships with MFIs and other agents, to provide services to the poor segment. Adoption of the BC channel as well as provision of wholesale funding to MFIs could be options. Indeed, commercial banks, both in public sector and the private sector, have both utilised these channel to serve this segment. Similarly, there is need to revisit the RRBs old relationship with SHGs through bank linkage, where experience shows that a critical mass of clients aggregated through this agency or cluster-level federations could lead to viable operations. Such an approach could help both to reposition RRBs as development oriented banks in the service of the poor, as well as to be in harmony with the objectives and programmes of financial inclusion.

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Ashok Reddy	Chairman, KVGB
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Appendix 2: Progress under PMJDY for Selected RRBs

S. No	Bank	Products offered	Infrastructure support	Remarks
1	Andhra Pragathi Grameena Bank	• Basic Savings bank deposit account • Smart Card • KCC/JL (Ag)/Produce Loan • Loan to SHGs • Direct Benefit transfer • Bancassurance	• Brick and Mortar branches • BC outlets/CSP • USB • Financial Literacy centers	• Initiated the FIP by entering into agreement with TSP – HCL Infosystems Limited, Hyderabad • The bank has deposit insurance and Personal Accident Coverage Scheme • The bank has initiated two new products- Pragathi Dhan Varsha- 555 days and Pragathi Kisan Swarna • The FI customers are provided with smart card and the BCA with master card and Hand Held Machines to conduct operations • Through their FLACs, more than 32407 persons opened accounts with banks. The transactions through BCs also improved substantially • The branches have organized 357 Farmers' Clubs and the branches have, in association with the clubs, have conducted various extension activities.
2	Assam Gramin Vikash Bank	• Savings bank account • Recurring Deposit Account • Current Deposit Account • Basic Savings Bank Account • Kisan Credit Card • General Credit Card • SHG- Bank Linkage • Joint Liability Group • Biometric Smart Card • FLCs • Micro Insurance	• Brick and Mortar branches • USB • CSP • FLC	• For all technical support, IT solutions and fine tuning BC model and for fast and smooth implementation of FIP a corporate BC/TSP "M/S Senrysa Pvt Ltd" has been empanneled • A cell for FI has been constituted with sufficient staff headed by one Chief Manager at Bank's Head office for overall follow up monitoring, liaison with Govt. Department RBI, NABARD, Bank's Regional Offices, Corporate BC and submission of reports/Return • One nodal officer has been deputed to every regional office for follow-up, monitoring of FIP implementation at branch level as well as BCA's Level • All the CSPs/BCAs empanelled have been provided , POS machines, Cap & Vest, Identity cards. They have been trained for system operation as well as for customer service. For viability of the CSPs/BCAs they have been empanelled as Business facilitator of the base branches on commission basis. • From time to time the review of the progress of FIP is being done in the Performance review meeting of

				regional offices and branches. • To encourage the BCs and CSPs the best performers are recognized and awarded.
3	Deccan Grameena Bank (Telangana Grameena Bank)	• Basic Savings Bank Deposit Account • DBT/EBT • RD-FI • Rupay debit card • Housing loans • Agriculture Term loans • Recurring Deposits • Life Insurance • Rupay Kisan Credit Card • Rupay debit card	• Brick and Mortar Branches • CSP • USB • FLC	• In FLAC the module covered are importance of savings, advantages of savings with banks, money management, issue of RuPay debit cards, insurance coverage, overdraft facility, availability of financial services in the remote places by using technology, borrowings from the banks will be at cheaper interest hitherto borrowed from money lenders, benefit in prompt repayment of the loans and gave satisfactory feedback • Extend overdraft facility on BSBD accounts on satisfactory operation in the accounts for six months to prevent them to approach money lenders to avail loan at exorbitant of rate interest.
4	J & K Grameen Bank	• Basic Savings Bank Deposit Account • Recurring Depsoits • Life and non-life insurance • KCC • GCC • Smart cards	• Brick and Mortar branch • USB • CSP/banking Outlets • FLCs • PoS machine	• The areas covered are hill prone, militancy infested and border area where the outreach of other commercial banks is almost negligible. • The bank is among the few RRBs who introduced the facility of bringing foreign inward remittances from abroad in India in rupees and made a tie up agreement with western union money transfer services • Representatives from Line departments like Agriculture, Horticulture, Animal Husbandry etc are invited in these Financial Literacy cum awareness programmes. The village Sarpanch/Panches/Lambardars are invited to speak on occasion and feedback is collected on the spot.
5	Jharkhand Grameen Bank	• Basic Savings Bank Deposit Account • DBT/EBT • Loan to SHG • Housing loan • Education Loan • Artisan Credit Card • Swarozgar	• Brick and Mortar branches • PoS • USB	

		Credit Card		
6	Kashi Gomti Samyut Grameen Bank	• Basic Savings Bank Deposit Account • Savings bank • Cumulative Deposit scheme • Deposits reinvestment certificate • Monthly income scheme • Kiran Jama Yojana • Micro insurance • ATM enabled KCC Rupay card • DBT/EBT • Rupay Kisan Credit Card • Loan for agriculture graduates • Swasthya Pashu Dhan Yojana	• Brick and Mortar branches • PoS • Financial Literacy Centres	• First Gramin Bank in India to become 100% CBS • First Gramin Bank to provide fastest remittance facility through NEFT and RTGS services for its customers across all branches. • Digital Authority Cheque introduced for better internal control and checks • SKOCH award (For financial Inclusion for employement generation and saving the environment by introducing the Solar Micro grid and Integrated (Light & Stove) Domestic Energy System with assistance of The Energy & Resourec Institute ,New Delhi and Norway • To provide Micro Insurance i.e. saving-cum-insurance cover to its customers at a minimum premium, Bank has entered into tie-up arrangement for 3 years with M/s Bajaj Alianze Life Insurance Company Limited to sell their product 'Sarva Shakti Suraksha Scheme' through its branches. In this scheme, the customer gets 41.66 times insurance cover of of its annual premium. Its annual premium ranges ` 600 as minimum to maximum ` 9600. • Member of governing council of National Payment Corp. of India.
7	Kaveri Grameena Bank	• Basic Savings Bank Account • Recurring Deposit • Life/non-life insurance • Pension fund • KCC/Rupay KCC • Rupay Debit Card • General Credit Card • DBT		• Rent plus credit- Owners of buildings & Commercial properties which are to be rented or already rented. Purpose- To meet liquidity mismatch / any other purpose of the applicant • The Bank has continued its involvement in the matter of Non-Conventional Banking activities by way of formation of Self Help Group, nurturing and financing with a mission and zeal. The work done by the Bank is well appreciated by various Government agencies, NGOs and others. • The Bank has continued its presence in other areas like financing for solar lighting, Rural Toilets and affordable Insurance coverage to economically weaker sections of the people

				especially in the rural areas. The Bank`s thrust of Sampoorna Concept i.e. covering whole village under a particular scheme rather than scattered coverage over a wide area is continued. The Schemes covered under Sampoorna Concept are Sampoorna Solar Grama, Sampoorna Smoke free Grama, Sampoorna Swacha Grama, Sampoorna Vima Grama, Sampoorna Money Lenders Free Grama and Sampoorna Kisan Credit Gramas. • As of now 6 villages are covered under the Sampoorna Concept and 18 villages are completely declared as Sampoorna Solar Gramas.
8	Pallavan Grama Bank	• BSBDA • General Credit Card • Kisan Credit Card • SB cum overdraft facility • Life/Non-life insurance • Recurring Deposit • DBT through PoS • EBT remittances • Smart Card • Mobile banking technology • OD facility	• PoS • USB • Brick and Mortar branches • FLC • Urban FI through BC	The bank introduced the following FI products to mobilize the micro savings from the unbanked and financially excluded population: – PallavanAkshaya Savings Bank – a Basic savings bank product with zero balance and in built overdraft facility uptoRs 5000/- – PallavanKathiroliKanakku – a General Credit Card Overdraft product facilitating customers to have the facility uptoRs 25000/- – Bank entered into MOU with Bajaj Allianz Ltd and covering the rural poor with their micro insurance product. Bank is also a corporate agent for UIIC and LIC • The Bank has introduced mobile enabled Pallavan m-Kisan Credit Card Project with the grant assistance of NABARD. The facility provides farmers to undertake cashless purchases of agricultural inputs like seeds, fertilizers, pesticides etc and make the payment from the farmer's KCC account to the supplier by using their mobile telephones. – Mobile Banking for SHG members for internal lending. – Special Mobile Banking Project launched in Department Stores for the customers of the Bank for making retail purchase as well as cash withdrawal upto Rs.1000/- – SMS alert to customers for financial

				transactions.
9	Pandyan Grama Bank	• Short deposits • Fixed deposits • BSBDA • Recurring deposits • Life/Non-life insurance • Rupay KCC card • Remittances • DBT/EBT • Fisheries loan • Allied Activity loan • GCC	• Mobile van banking • Satellite banking • FLCs • PoS • Brick and mortar branches	• Higher contribution to priority sector advances (i.e) 95% as on 31.03.2014 as against the mandatory 40% • Assistance to illuminate through solar light assistance in the tribal hamlets of Kaanikudiiruppu, in the western ghats and the fishermen colonies of Dhanushkodi, the coastal region - are worth mentioning.
10	Pragathi Krishna Gramin Bank	• Saving Bank Account • BSBDA • Daily deposit account • SB A/C with personal accident insurance cover • Fixed deposit • Term deposit • Life insurance	• PoS • Mobile • Brick and Mortar branches • FLC	• Bank has been disbursing Social Security pension at the door steps of the rural poor by engaging the services of BCAs to 2,82,322 EBT beneficiaries. • The Bank has distributed 2,96,978 Smart cards during the year making a total tally of 6,70,680. • The Bank has also conducted through BCAs highest number, 9,37,391 of transactions at the doorsteps of the rural poor involving an amount of

		• Horticulture/plantation loan • Minor irrigation and pumpset loan • KCC • GCC • Swarojgar credit card • Mobile banking		Rs.47.6 crores. • Bank has also been conferred award called :Surya Mitra" by SELCO for outstanding service in promoting use of Solar Energy. • Bank is second largest RRB in India and first in Karnataka State with a business of Rs.16,697 crores with ATM network of 155, largest network of any RRB in Karnataka
11	Prathama Bank	• Savings deposit account • Fixed deposit scheme • Social Security deposit – An ideal money/quarterly income plan • Fixed deposit • Daily savings scheme at doorstep • BSBDA • KCC • Swarojgar Credit Card • Retails credit card	• Brick and Mortar branches • Mobile van • CSP • PoS • FLC	• Paying MNREGA wages, Pld age pension, Widow Pension and Scholarship benefit • Our FI initiative in new avatar started in December 2010 by deploying **3 Mobile Banking Vans** covering 30 villages with our own staff delivering the banking services. Further, since August 2011 Financial Inclusion was given fresh impetus through BC model utilizing Information Communication Technology (ICT) banking services with HCL as Technology Partner • Solar home light system for the set of villages
12	Punjab Grameen Bank	• BSBDA • Savings Account • Vidyarthi Account • Fixed deposit • Recurring Deposit • Micro Insurance • KCC/KCC Rupay Card • GCC • Swarozgar Credit Card • Life Insurance/Health insurance	• Kiosk • FLC • Brick and Mortar branches	• Beneficieries can avail Cash NEFT facilty up to Rs. 100000/-, availbale in all the branches - without paying any service charges / commission. • Medical / Health Insurance (only for PGB Customers)- available with small premium Rs. 800/- per person aged up to 55 years, (maximum sum assured 50000/- for accidental hospitalisation) cover avilable for 10 Critical illness + personal accidental + Hospital cash benefit of Rs. 500 per day up to Rs. 10000/-). • Services of NEFT and interoperability of the KBS of BC points with Core Banking Solution is also available. • Cash Deposit, Cash Withdrawal, Inter branch Transfer amount, Passbook, Rupay Debit Cards, NEFT facility and above all the door step banking services is being provided to the Customers at BC Points from 8.00 AM to 8.00 PM.

				• Intrinsic OD facility to BSBD Customers
13	Rajasthan Marudhara Gramin Bank	• BSBDA • SB account • Recurring deposit • Fixed deposit • KCC • Swarozgar Credit Card • Artisan Credit Card • Overdraft • Life Insurance	• Brick and Mortar branches • Kiosk • FLC	
14	Sarv UP Grameen Bank	• BSBDA • RD/Flexi RD • FD • KCC	• Brick and Mortar branches • Kiosk Banking • FLC	• Bank has started KIOSK Banking online model of Financial Inclusion during 2013-14 and was 1st among all 7 RRBs operating in the state of UP by 31st March 2014. • This is online model and the transactions are carried on real time basis. The time of operation can be 24 X 7, but initiolly we have permitted for 8 AM to 8 PM. The BCA provided the services at the doorstep of the customer a part from its fixed location. • Timely payment of their remuneration as bill is generated online.
15	Uttarakhand Gramin Bank	• KCC/Rupay KCC • Women Credit • DBT • Artisan Credit Card • Swarozgar credit Card • Term deposit • Life/Non-Life insurance	• Brick & Mortar Branches • Satellite Office • Extension Counter • BC Outlets • USBs • Tablet based Micro ATMs • PoS • Kiosk • FLC	• In ICT based Financial Inclusion UGB is in number one position as compared to other banks, since tablet based Micro ATM has been successfully launched apart from PoS and KIOSK banking and Bank is itself maintaining FI server which is fully integrated with CBS server facilitating ON Line Transaction. It has been accomplished with successful coordination made among BC/CSPs, Technology provider, CBS service provider and Branches, by Financial Inclusion Deptt under the able guidance of the Chairman and both General Managers. • Tablet based and laptop based Micro ATM launched with the support of NABARD under FITF. FI server installed at Head Office. FI server integration with CBS server, making ON line transaction successful.

S.No	RRB Name	Sponsor Bank	Accounts Rural	Accounts Urban	Total Accounts	Aadhar Seeded	Aadhar Seeded -%	RuPay Card Issued	Rupay Card - %	Deposits in Lacs
1	Andhra Pragathi Grameena Bank	Syndicate Bank	271561	162462	434023	341055	78.58%	418164	96.35%	5281.53
2	Assam Gramin Vikash Bank	United Bank of India	1131266	19057	1150323	5	0.00%	978938	85.10%	9232.44
3	Deccan Grameena Bank	State Bank Of Hyderabad								
4	J & K Grameen Bank	J & K Bank	50209	9671	59880	0	0%	0	0%	1066.8
5	Jharkhand Gramin Bank	Bank Of India	203575	33891	237466	58069	24.45%	231174	97.35%	74.28
6	Kashi Gomti Samyut Gramin Bank	Union Bank of India	443551	110354	553905	0	0%	358202	64.67%	3291.83
7	Kaveri Grameena Bank	State Bank of Mysore	270411	78949	349360	270792	77.51%	300945	86.14%	1244.36
8	Pallavan Grama Bank	Indian Bank	156640	13925	170565	18716	10.97%	26000	15.24%	694.62
9	Pandyan Grama Bank	Indian Overseas Bank	62969	770	63739	4839	7.59%	998	1.57%	389.15
10	Pragathi Krishna Gramina Bank	Canara Bank	314226	227812	542038	176581	32.58%	539257	99.49%	1445.54
11	Prathama Bank	Syndicate Bank	262874	29675	292549	17740	6.06%	258455	88.35%	6023.55
12	Punjab Gramin Bank	Punjab National Bank	92930	33334	126264	90257	71.48%	99951	79.16%	586.82
13	Rajasthan Marudhara Gramin Bank	State Bank of Bikaner & Jaipur	844928	25044	869972	298234	34.28%	722422	83.04%	8003.06
14	Sarv UP Gramin Bank	Punjab National Bank	325241	109565	434806	30156	6.94%	65620	15.09%	4102.59
15	Uttarakhand Gramin Bank	State Bank of India	156353	6654	163007	15427	9.46%	122150	74.94%	1546.56