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AN ANALYSIS OF FINANCIAL PERFORMANCE OF REGIONAL RURAL BANKS - WITH SPECIAL REFERENCE TO KERALA GRAMIN BANKS

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ABSTRACT

In different states of India, Regional Rural Banks (RRB) are acting as local level banking organizations. They have been created with a view to serve primarily the rural areas of India with basic banking and financial services. Government of India had notified the area of operation of RRBs and it covers one or more districts in a state in the present study an attempt is made to analyze the financial performance of Regional Rural banks on the basis of the Kerala Gramin Bank (KGB) – the RRB in Kerala. For the study the financial results of KGBs from 2013 to 2016 is considered. CAMEL ratios have been applied to assess the performance. The results reveal that capital adequacy and asset quality performances are excellent in the KGB. The ratios related to managerial efficiency also shows satisfactory results. KGB needs improvement in their earning capacity and liquidity position.

KEYWORDS: Asset Quality, CAMEL Ratios, KGBs, RRBs

INTRODUCTION

In the early 1970s, there was a feeling that even after nationalization of banks, there were cultural issues which made it difficult for commercial banks, even under government ownership, to lend to farmers. This issue was taken up by the government headed by Smt. Indira Gandhi and it set up Narasimham Working Group in 1975. On the basis of this committee's recommendation, a Regional Rural Banks Ordinance was promulgated in September 1975. The RRB Act 1976 and the ordinance passed on Sept, 1975paved the way for the establishment of Regional Rural Banks. It provides sufficient banking and credit facility for agriculture and other rural sectors.

The development process of RRBs started with the formation of the Prathama Bank (the Ist RRB) on 2nd Oct, 1975. Five regional, rural banks were set up with a capital of Rs. 100 crores on 2nd Oct, 1976. The owners of RRBs were in the joined hands of the Central Government, Sponsor bank and the State Government. The five commercial banks, namely United bank of India, Punjab National Bank, State Bank of India, Syndicate Bank, United Commercial Bank and United bank of India act as sponsor banks. The central government held 35%, State government 15% and Sponsor bank 50% of the shares of RRBs.

Regional Rural Banks are local level banking organizations operating in different States of India. They have been created with a view to serve primarily the rural areas of India with basic banking and financial services. The other functions of RRBs include pension distribution, helping the government by engaging in the disbursement of wages to the workers under MGNREGA scheme. Apart from providing banking services to rural and semi urban areas, it also extents Para- banking facilities like debit cards and credit cards and locker facilities.

Financial Performance of RRBs in India

Owned funds, deposits, funds from NABARD, SIDBI and Sponsor bank constitute the fund source of RRBs. The uses of funds comprise of investments, loans and advances and loans issued. The proper management of sources and uses shows the financial performance of RRBs the Financial result is measured through the criteria like profitability position, Position of accumulated losses, Position of NPA, recovery performance and credit deposit ratio (CDR). As per NABARD records the performance of RRBs can be evaluated as follows

Table 1: Key Performance Indicators (2012-13)

Performance Indicator	Value
Net profit	3281 crores(63)
Net loss	2.7 crores(1)
Accumulated loss	1012 crores(11)
NPA	3.4%

Figures in brackets represent numbers
Source: NABARD records

As per NABARD records concerning Profitability 63 RRBs (out of 64 RRBs) have earned profits (before tax) to the extent of Rs.3281 crore during the year 2012-2013. The profit was higher than the previous year. After payment of Income Tax of Rs.896 crore, the net profit aggregated to Rs. 2385 crore. One RRB viz. The Nagaland Rural Bank incurred loss to the tune of Rs.2.07 crore. The overall Accumulated Losses **as** on 31 March 2013, was Rs.**1012** crore as against Rs.1333 as on 31 March 2012. The accumulated loss decreased by Rs. 321 crore. The Gross Non Performing assets (NPA) of RRBs stood at Rs. 7907 crore as on 31.03.2013. The percentage of Net NPA of RRBs has shown an increase from 2.98% to 3.40% during the year. The data revealed that 10 RRBs had a gross NPA percentage of less than 2%, whereas 32 RRBs had it above 5%. The recovery performance improved from 81.32% (2011) to 81.60% as of June 2012. But even then the aggregate overdue, stood at Rs. 13567 crore on June 2012.

The aggregate Credit Deposit ratio (CDR) of RRBs increased over the years from 41.83% as on 31 March 2002 to 66.13% as on 31 March 2013. Nine of the RRBs reported CDR by more than 100%.

RRBs in Kerala - Kerala Gramin Bank (KGB)

On 08/07/2013 under the subsection (1) of section 3 of the RRB act 1976 Kerala Gramin Bank (KGB) is formed as RRBs in Kerala. Through a notification by the government of India, South Malabar Grameen bank and North Malabar Grameen bank are amalgamated to form Kerala Gramin Bank. The Sponsor bank of the KGB is Canara bank and its head office is in Malappuram. Having a total business of above 20,000 crores and spread throughout Kerala with a network of 565 branches, the KGB is having the fame of being the largest RRB in the country.

The Central Government, State government and Canara bank contribute towards the capital of the KGB, which extends to 2 crores rupees. Banks total deposits stood at 12678 crores and total advances stood at 9988 crores as on March, 2016. KGBs gives financial assistance to sectors like Micro, Medium and small enterprises apart from funding agricultural activities. It also extents education and housing loans to weaker sections and SC/ST categories and thus contributes much towards the development of Kerala. In the matter of financial performance it excels many of the major banks functioning in Kerala. The CD ratio of the KGB is the best when compared to many of the leading banks. KGBs performs a leading role in the functioning of Kisan Credit Card and SME (priority) schemes.

SIGNIFICANCE OF STUDY

The KGB, the merged entity of SMGB and NMGB, is the largest RRB in India. As mentioned above, RRBs have vital significance in the rural development of India. RRBs are formed with the vested objectives of effective rural credit delivery. Hence, they are working for a balanced, inclusive growth. In long run RRBs thus can ensure a sustainable growth process in the country. To perform these vested functions a strong and healthy financial culture is required for the bank. Hence an attempt is made to analyze the financial performance of KGBs from 2013 to 2016 using CAMEL ratios. The results/ findings of the present study are useful to the policy planners in their efforts to improve the working of the RRBs in India.

Research Questions

- What is the capital adequacy position of KGBs?
- What is the performance level of KGBs concerning the ability to recover outstanding loans and advances?
- What is the extent of managerial ability and efficiency to control the risk of KGBs?
- What is the quantity, trend and sustainability of the earning capacity of KGBs?
- Is the liquidity position of KGBs enough to meet its financial obligation?

OBJECTIVES OF THE STUDY

The overall objective of the study is to investigate into the financial soundness of KGBs using CAMEL ratings.

- To determine the bank's capacity to meet the time liabilities and other risks such as credit risk, operational risk, etc.
- To measure the asset quality.
- To analyze the efficiency and effectiveness of management quality.
- To measure the trend and sustainability of earning.
- To measure the level of liquidity.

Scope

The scope of the study is limited to Kerala Gramin Bank – the RRBs of Kerala. The study is concerned for a period from 2013 to 2016.

RESEARCH METHODOLOGY

Camel ratios have been used to analyze the financial performance of KGBs. CAMEL ratios are a popular model of ratios, which are generally used for assessing financial performance ratios. Capital adequacy, Quality of asset, Management efficiency, Earning quality and Liquidity position of the organizations are assessed with the help of this tool.

Here for the study consolidated financial statements of Kerala Gramin Banks for a period of 2013-2016 have been collected from the annual reports published by the bank.

Camel rating and the standard criteria set by camel ratings are used to examine the financial strength of KGBs with regard to capital adequacy, asset quality, management capacity, earning ability and liquidity.

CAMEL RATINGS

The CAMEL ratings are developed in the United States. It is a rating system which classifies the financial performance in five categories and thus measures the overall performance of the organization. It's a more suitable measure to judge the performance of banks. Ratio analysis techniques help in rating. This rating ensures a bank's healthy condition by reviewing different aspects of financial statement.

CAMEL rating scale ranges from 1 to 5. Banks scoring 1 are considered to be very strong and stable and those score 2 or 3 is considered to be moderately strong and those which score 5 is considered to be weak in their performance.

CAMEL is a term for five components. Here C stands for Capital adequacy, which measures the adequacy of capital to balance the risk exposures financiers. A stands for asset quality, which focuses upon measuring the extent of non performing assets. M stands for measuring managerial efficiency, which focuses upon the capability of management in measuring and reducing risk. E stands for quality of earning, and concentrates on the profitability of the organization. L stands for liquidity position and observes the level of liquidity to meet financial obligations.

Capital Adequacy

Banks are exposed to various types of risk like credit risk, market risk and operational risk. Capital adequacy refers to the minimum capital required to balance these possibilities of risk by the bank. A good Capital adequacy ratio helps to absorb the potential losses and protect the financial institution. In simple words, a bank's capital is the "cushion" for potential losses, and protects the bank's depositors and other lenders.

The important capital adequacy ratios calculated here are:

Capital Adequacy Ratio (CAR): The CAR is calculated by dividing the tier-1capital and tier-2 capital by the risk-weighted assets. Tier-1 capital includes the core equity, reserves and non cumulative preference share capital. Tier-2 capital includes undisclosed reserves, general provisions and subordinated debt.

Fund based assets like loans; cash, investments, etc. is known as risk weighted assets. Generally, cash and government bonds have zero % risk weight, whereas mortgage loans have 50% and all other assets have 100 %. Higher the ratio greater is the protection for the investors. In case of KGBs tier-2 capital is insignificant; the CAR is calculated by dividing tier-1 capital by the risk weighted assets.

Leveraged Ratio: Leveraged ratio is calculated by dividing tier 1 capital by its average total consolidated assets. The bank is well capitalized if its leverage ratio is greater than or equal to 4%.

Table 2: Capital Adequacy

Ratios	2013	2014	2015	2016	Average	Standard
CAR	5.0%	5.2%	4.9%	4.7%	4.95%	>=4
Leveraged ratio	3.7%	4.4%	4.2%	3.87%	4.0%	>=4

Source: Annual reports of KGB

On the basis of ratios under consideration it can be concluded that KGB is showing good performance concerning capital adequacy. Table 1 show that CAR rates are above the standards. Leveraged ratio also is up to the standard.

Asset Quality

The most important aim behind measuring the asset quality is to ascertain the component of non-performing assets as a percentage of the total assets. This indicates what types of advances the bank has made to generate interest income. The ratios commonly calculated are

Net Non Performing Assets to Total Assets: It is arrived by dividing NNPAs by total assets. It shows the efficiency of the organization in recovering debts.

Total Investments to Total Assets: It indicates the extent of deployment of assets in investment as against advances. This ratio is used as a tool to measure the percentage of total assets locked up in investments. It is derived by dividing total investments by total assets.

Table 3: Asset Quality

Ratios	2013	2014	2015	2016	Average	Standard
Total investments to Total assets	14.8%	14.9%	14.6%	17.5%	15.5%	>=20%

Source: Annual reports of KGB

NPA as per the published records are nil. So the ratios based on NPA are not calculated. Zero NPA position shows excellent asset management of KGBs. Total investments to Total assets is lesser than the standard and need improvement.

Management Capacity

Quality management is basically the capability of management, to identify, measure, and control the risk of an organization. This element of CAMEL model measures the efficiency and effectiveness of management. The ratios used to evaluate the management efficiency are

Total Advances to Total Deposits (TA/TD): This ratio measures how efficiently the deposits of banks are converted into higher earning advances by the management of the organization. In Advances receivables is included, whereas Deposits include savings deposit, demand deposit, term deposit and deposit of other banks.

Profit per Employee (PPE): This shows the surplus earned per employee. It is known by dividing the profit after tax earned by the bank by the total number of employees

Table 4: Management Efficiency

Ratios	2013	2014	2015	2016	Average
Total advances to Total Deposits	103.7%	90.2%	81.3%	78.8%	88.5%
Profit per employee	77.7	117.9	119.2	221.4	134.0

Source: Annual reports of KGB

Ratios relating to management capacity of KGBs are higher. Higher ratios show better managerial capacity. Total advances to total deposits shows an average of 88.5% and Profit per employee shows an average of Rs. 134.0 Concerning management ability KGBs is showing excellent performance.

Earnings Quality

This element in the CAMEL rating indicates the quantity, trend and sustainability in earnings of the organization. The ratios calculated under this category are

Net Profit to Assets: Here the efficiency in utilization of assets is measured. The ratio is derived by dividing net profit by total assets.

Interest Income to Total Income: In this ratio a comparison between interest income and total income is done Interest – the income from lending activities are calculated as a percentage of the bank's total income of a particular year. Here the percentage of the interest income to total income is measured.

Non Interest Income/Total Income (DIVERSIFICATION RATIO): This measure the income from operations other than lending's as a percentage of the total income.

Return on Equity: This ratio shows the net profit as a percentage of the equity share holdings. It is an important measure of earning ability

Table 5: Earning Quality

Ratios	2013	2014	2015	2016	Average
Net profits to Assets	.24%	3.27%	.27%	.46%	1.06%
Interest income to total income	93.8%	93.6%	93.4%	93.3%	93.5%
Diversification ratio	6.2%	6.4%	6.6%	6.7%	6.5%
Return on equity	5.6%	7.8%	7.3%	12.0%	8.2%

Source: Annual reports of KGB

Interest income to total income shows satisfactory position of earning quality. But Return on equity position is not satisfactory. The overall ratios based on earning quality depict that KGB needs improvement concerning this aspect.

Liquidity

It's very important to maintain a level of liquidity sufficient to meet the financial obligation of the organization. The banks have to maintain a proper balance between liquidity and profitability. The important ratios applied are:

Loan to Deposit Ratio (LTD): It is a commonly used measure for assessing a bank's liquidity by dividing the banks total loans by its total deposits. If the ratio is high, then it indicates that the liquidity position is not satisfactory to meet the unexpected financial requirements of the organization and if it is very low, it is assumed that the bank is not earning up to its capacity.

The Ratio of Liquid Assets to Total Assets (LA/TA): It shows a comparison between liquid asset and total assets of the bank. It gives an assessment about the overall liquidity of the bank. Liquid asset includes cash in hand and at bank, money at call etc.

The ratio liquid assets to total deposits (LA/TD): This measures the security of deposits in the bank. Here the extent of liquid assets to total deposits is measured.

Table 6: Analysis of Liquidity

Ratios	2013	2014	2015	2016	Average	Standard
Loan to deposit	103.7%	90.2%	81.1%	78.8%	88.45%	=<80%
Liquid asset to total deposit	21.41%	26.97%	35.11%	22.4%	26.47%	
Liquid asset to total asset	14.09%	18.94%	24.83%	17.57%	18.86%	

Source: Annual Reports of KGBs

Loan to deposit ratio of the KGB is slightly higher than the standard. Higher the ratio, the greater is the banks difficulty to face unexpected deposit withdrawals as illiquid loans cannot be monetized. The other two ratios –Liquid asset to total deposit and Liquid asset to total asset are favorable when they are higher. These ratios of KGBs need improvement.

CONCLUSIONS

Kerala Gramin Bank (KGB) is a Regional Rural Bank (RRB) formed on 08.07.2013 by amalgamating the two RRBs of Kerala namely South Malabar Gramin Bank and North Malabar Gramin Bank. Only four years financial results are available for analyzing the financial performance of KGBs. CAMEL rating has five major criteria. This study has been conducted to examine the overall performance of KGBs on the basis of the criterion of camel ratings. The study revealed the following

- The performance of KGBs concerning capital adequacy is satisfactory.
- The management of Nonperforming assets (NPA) is excellent, but concerning the aspect of transferring investment to assets KGBs need to improve.
- The management ability as per the ratios are highly satisfactory.
- The earning ability ratios show that KGB needs improvement in that aspect. Interest income is satisfactory whereas return to equity needs improvement.
- The overall liquidity position is not satisfactory

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