A STUDY ON THE IMPACT OF OPERATIONAL EFFICIENCY ON PROFITABILITY IN REGIONAL RURAL BANKS (WITH SPECIAL REFERENCE TO THE M.P)

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ABSTRACT

However, the banking sector has witnessed a huge growth in the recent years. Despite such a growth, the credit flow by banks to the rural and agricultural sectors remains dismal, which, more or less, has resulted in financial exclusion of the rural masses. Regional rural banks have to play up major role to finance and provide landings to agriculture sector at diminishing rate of interest in order to grow the economy and GDP. It requires better financial management of the RRBs. The purpose of this study is to examine the impact of operational efficiency on profitability in RRBs. This study concentrates on the principles of bank management for assets and liabilities. The study helps in efficiency in financial management and reduces the misuse of funds, proper estimation of total financial requirements**,** **p**roper mobilisation**,** utilisation of finance**,** maintaining proper cash flow**,** to increase efficiency**,** reduce cost of capital and maximize the profit in long run of RRBs.

Key Words: Operational Efficiency, Utilization of Funds, Profitability, Rich Economy

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INTRODUCTION

In 1975 the Government of India had appointed a working group on Rural Banks to study, in depth, the setting-up of new rural banks to provide the credit requirements of the rural people. It felt that there was a need to set up new institutions and operational ethos entirely different from those obtaining in the public sector banks. The Working Group examined the structure and functioning of the Co-operative credit agencies and commercial banks and brought out the strengths and weaknesses of both. In conclusion, the working group envisaged a new institution which "combines the local feel and familiarity with rural problems. The co-operatives possess the degree of business organisation, ability to mobilise deposits, access to central money markets and modernised outlook which the commercial banks have.

RRBs, with their wide expansion in rural India focused on the centric banking activities and close relationship with the local authorities and population, were expected to cater to the credit requirements of the rural areas and provide necessary banking infrastructure. Though the RRBs have been able to mobilise small savings of the rural sectors. They have been relatively less successful in enhancing the flow of credit to the targeted rural poor. RRBs have played a key role in rural institution financing in the term of geographical coverage, clientele outreach, business volume & also contribute to development of rural economy. A remarkable feature of their performance over the past four decades has been massive expansion of their retail network in rural areas.

The Management of each RRB is vested in a nine member Board of Directors, headed by a Chairman who is appointed by a Government of India. In discharging its functions, the Board of Directors is required to act on business principles and in accordance with directives issued by the Government of India after consultation with the Reserve Bank. While a RRB is empowered to appoint officers and other employees, their remuneration is prescribed by the government of India in accordance with the salary structures of the employees of the state government and local authorities of comparable level and status in the area of operation of the RRBs.

All the RRB's setup has been included in the second schedule to the Reserve Bank of India Act. The amendments met to the Reserve Bank of India Act enable the Reserve Bank grant assistance to the RRB's by way of loans and advances.

The Regional Rural Banks are scheduled commercial banks supported by Government but sponsored by nationalised commercial banks. The authorised and issued capital of the Regional Rural Banks is Rs.100 lakhs and Rs.25 lakhs respectively. The share capital is contributed by the Central Government, respective State Governments and the sponsoring Commercial bank in the proportion of 50 :15 : 35 respectively. Board of Directors controls and regulates the affairs of the Regional Rural Bank. Of the nine Directors, three are nominated by the Central Government, two by the State Government and four including the Chairman by the sponsoring Commercial bank. The Chairman is a full-time professional executive, appointed by the Central Government. Initially, the services of the Chairman are obtained from the sponsoring commercial bank on deputation. Except Chairman, Regional Rural Banks can appoint all the other staff, i.e., Branch

Managers, Accountants, Technical officers, Field officer, Field Assistant, Cashiers, Clerks etc. Those within the operational power of the respective Regional Rural Bank and with rural knowledge and orientation are to be selected on the staff, with active secretarial support, from the sponsoring commercial banks. In fact, as per Regional Rural Bank Act, 1976, the whole responsibility of staff training, free of cost, lies on the sponsoring commercial banks for an initial period of five years. The remuneration paid to the staff directly recruited by the Regional Rural Banks is prescribed by the Government of India. The structure of the remuneration is uniformly lower than that applicable to the staff of the sponsoring commercial bank. The Government of India has laid down that the structure of remuneration payable to the staff of the Regional Rural Bank should be on par with the salary structure of the employees of the State Government and local authorities of comparable level and status in the area of the Regional Rural Bank.

REVIEW OF LITERATURE

Singh, Kuldeep in his research study "Performance Evaluation Of Regional Rural Banks"(2014) found that "The institution of Regional Rural Banks (RRBs) was created to meet the excess demand for institutional credit in the rural areas, particularly among the economically and socially marginalized sections. Although the cooperative banks and the commercial banks had reasonable records in terms of geographical coverage and disbursement of credit, in terms of population groups. The cooperative banks were dominated by the rural rich, while the commercial banks had a clear urban bias. In order to provide access to low-cost banking facilities to the poor, the Narasimham Working Group (1975) proposed the establishment of a new set of banks, as institutions which "combine the local feel and the familiarity with rural problems.

Ahmed, J. Uddin in his research study "Performance Evaluation of Regional Rural Banks: Evidence from Indian Rural Banks" (2013) examined the genesis of the Regional Rural Banks (RRBs) for around three and half decades can be traced to the need for stronger institutional arrangements for providing rural credit. The inception of RRBs can be seen as a unique experiment as well as experience in improving the efficacy of rural credit delivery mechanism in India. In the wake of introduction of financial sector reforms, the feasibility of RRBs emerged as the most crucial factors in deciding the desired role due to their limited business flexibility with hardly any scope of diversification, smaller size of loans with higher exposure to risk prone advances and professional inefficiency in financial deployment. In order to strengthen RRBs and to improve their performance, various initiatives have been taken by the Government of India and

Reserve Bank of India. The study, therefore, is a synopsis on the evaluation of performance of RRBs in India with respect to deposit mobilization, credit channelization, credit deposit ratio, deployment of credit to various occupations etc.

Subudhi, R. N and Ram, Jitendra K. in their research study "Operational Efficiency of Regional Rural Banks and Other Commercial Banks of Odisha India: A Comparative Study" (2012) disclosed that "Banks play an important role in the economic development of a state. The banks play the role of financial intermediaries in the economic development of a state. The commercial banks help in flow of investment capital throughout the market place. The main tool for resource allocation in the economy is to credit disbursed by the banks. When the performance of the banks is evaluated in lieu of the services provided to the larger societies. It is found that a glaring bias of public sector (PS) banks only for the urban areas. But Odisha has a population of 4.20 crore, of which 3.50 crore (83.33%) live in (51313) villages (as per 2011 census). Out of 51313 villages of Odisha, commercial banks function only in 1724 villages. The banking system in Odisha consists of public sector banks, private banks, development banks, specialized banks, and cooperative banks. Through this study an attempt has been made to assess whether the commercial banks functioning in Odisha have properly discharged their responsibilities towards the economic development of the state, especially rural Odisha (India).

Suman in her study " Role of Regional Rural Banks in Growth, Employment, Income And Development of Rural Population"(2012) explored that evolution of an effective institutional credit structure, which can meet the credit needs of the rural economy, has been one of the basic objectives of credit policy in India. Commercial banks have little interest in rural areas, these banks concentrated on deposits rather than credits. The nationalization of major commercial banks also did not improve the situation to any great extent. Less than 1% villages availed financial facilities from commercial banks. So there was strong need for the establishment of Regional Rural Banks. The rapid expansion of Regional Rural Banks has helped in reducing substantially the regional disparities in respect of banking facilities in India. Generation of additional sources of income and employment in rural population has been the main objective of Regional Rural Banks. The banks are striving hard to provide best banking service in its command area. Government should take some effective remedial steps to make Gramin Banks viable.

OBJECTIVES OF THE STUDY

1. To determine and analyze the impact of operational efficiency on profitability in RRBs.
2. To make suggestions or the improvement in the efficient management of profitability in the RRBs of Madhya Pradesh.

H_{01}: There is no significant impact of Operational Efficiency on Profitability of RRBs.
H_{11}: There is a significant impact of Operational Efficiency on Profitability of RRBs.

RESEARCH METHODOLOGY

Research may be deductive or inductive. Deductive research approach begins with the development of a theory or hypothesis and later a development of a strategy to test it in a context to verify or reject its claims

SECONDARY DATA

To test the hypotheses secondary data have been collected and compiled together to conclude the results. To test the objectives following secondary data were taken from the Bank Reports separately from Madhyanchal Gramin Bank, Central M.P. Gramn Bank and Narmada Jhabua Gramin Bank. For this study four years data have been calculated (2011-12 to 2014-15) as on March Ending Year. To test the first objective, for the measurement of operational efficiency and its impact on profitability in RRBs.

TABLE 1.1 :MODEL SUMMARY[B] ON OPERATIONAL EFFICIENCY AND PROFITABILITY OF RRBS

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.830[a]	.768	.702	2.76797	.768	12.108	1	2	.000

a. Predictors: (Constant), Operational Efficiency

b. Dependent Variable: Profitability

The given table below shows the correlations and it is evident from this table that Pearson's correlation coefficient between Operational Efficiency and Profitability of RRBs is 0.830 which is significant since the significant value (p- value) 0.000 is less than 0.05. Therefore, we may conclude that there is significant association between Operational Efficiency and Profitability of RRBs. Furthermore, since the value of correlation coefficient r suggests a strong positive correlation, we can use a regression analysis to Model the relationship between the variables.

TABLE 1.2 : COEFFICIENTS[A] ON OPERATIONAL EFFICIENCY AND PROFITABILITY OF RRBS

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.	95.0% Confidence Interval for B	
		B	Std. Error	Beta			Lower Bound	Upper Bound
1	(Constant)	-6.176	12.630		-.655	.580	-62.618	46.066
	Operational Efficiency	.071	.017	.932	3.630	.068	-.012	.138

a. Dependent Variable: Profitability

Over all model summary shows the value of linear correlation coefficient R=0.830, it is the linear correlation coefficient between observed and model predicted values of the dependent variable, Its large value indicates a strong relationship. $R^{2,}$ the coefficient of determination is the squared value of the multiple correlation coefficient. Adjusted R^2=0.768, R^2 change is also 0.702 and these values are significant which shows that overall strength of association is noteworthy. The coefficient of determination R^2 is 0.702; therefore, 70.2% of the variation in Profitability is explained by Operational Efficiency. ANOVA is used to exhibit model's ability to explain any variation in the dependent variable. ANOVA table exhibits that the hypothesis that all model coefficients are 0 is rejected at 1% as well as 5% level of significance which means that the model coefficients differ significantly from zero. In other words we can say that there exists enough evidence to conclude that slope of population regression line is not zero and hence, Operational Efficiency is useful as predictor of Profitability.

From the table of coefficients, the regression equation can be obtained as

Profitability= 6.176 + .071* Operational Efficiency

The normal probability plot is obtained to test the assumption about the normality of residuals and it appears that the residuals are approximately normally distributed. Thus the assumptions for regression analysis appear to be met.

DISCUSSION

For the hypothesis stated ***there is no significant impact of Operational Efficiency on Profitability of RRBs.*** To test the hypothesis correlation and regression were applied and it is concluded that there is a significant impact of operational efficiency on profitability in RRBs Bank. The important values, generated by SPSS through running regression on the data collected are as follow: Coefficient of Correlation, R-.830, Coefficient of Determination, R2-.768, F-Test Value-12.108 at P-value-.000 and lastly tolerance level is determined through Coefficient of independent variable, Beta-6.176. The calculated value of F is higher than tabulated value at 5% significant level, so null hypothesis is rejected and alternate hypothesis is accepted. The value of T-test is 3.630 **{Refer Table No. 1.1** is significant at 5% level of significance. F value is greater at 1 degree of freedom. Hence, the relationship between independent variable and dependent variable is .830 and 76.8% change is explained in the variable of profitability by operational efficiency in RRBs Bank. **{Refer Table No. 1.2** The estimated regression model of data shows that there is a (strong effect) positive relation between profitability and operational efficiency. It also tells us that a change in operational efficiency (RRBs bank) will enhance up to 6.176 profitability. The F-calculated value is 12.108, so, the overall model is significant under the condition that F- calculated > F- tabulated. In this case the data shows that the model is significant at p-value. The p-value from the result is less than 0.05. Thus, the null hypothesis is rejected and the alternative hypothesis is accepted. The findings are statistically significant at the 5% level. The findings concluded that the operational efficiency is an important measure to determine the impact on profitability.

Profitability is key to any business because it allows the business to expand and provide more and a broader range of services to a larger number of people. Efficiency can be defined as how well a company uses its assets and liabilities internally. In the environment of volatile interest rates, demanding customers, greater need for financial inclusion, competition for human capital, restrictions of lending in terms of own funds, it is absolutely essential that banks operate and utilise their resources efficiently. Hence, it is important to evaluate a bank‘s performance based on the efficiency with which a bank used its human, technological and financial resources. Therefore efficiency has been selected as a major criterion for measuring the performance of banks.

RRBs also use group lending and guarantees by salaried individuals to reduce credit risk. The use of insurance, asset collateral, and other financial risk management tools is not common in the rural banks. Microfinance groups have monthly savings that are separate from the group loan account that will be used to repay the loan in case of default. Additionally, the banks hold a certain percentage of all loans as security. For microfinance loans, individual savings of group members are used as security.

Boards of RRBs are increasingly involved in cases of delinquency, and this has reportedly improved loan recovery. In cases of delinquency, the bank management usually notifies the board. The board and the credit officer follow up with the client. Board members may also visit the client at his or her household or business. If a loan is delinquent for three months, a demand notice is sent to the client and the case is transferred to the bank’s lawyer. In some cases, village chiefs are also involved in persuading the borrower to repay the loan. In case of lending to individuals via a group, the group chairperson, the treasurer, and other group members work together to recover the loan from the individual. In some cases, groups have paid the amount due from their group savings.

CONCLUSION

The RRBs follow the actions of the commercial banks in the matter of deposits and advancing loans which are very complex and time-consuming from the villagers. The rural borrowers always appreciate easy ways and simple procedures as have been followed by the money-lenders and the indigenous bankers. The RRBs come crossed a number of realistic difficulties in deposit mobilization. On account of their restrictive lending policy which excludes richer sections of the village society, these potential depositors show least concern in depositing their money with these banks. The significant growth of rural bank outreach among depositors and borrowers demonstrates the ability of the rural banks to provide services to an increasing number of clients but due to fluctuations in inflation observed in the statistics sometimes it increases or decreases. Appropriate lending technology and credit risk management are among the most important factors in the sustainability of a lending institution. The tasks involve identifying creditworthy borrowers, appraising and approving loan applications in a timely manner, managing credit portfolios so that revenue is maximized and delinquencies minimized, and taking appropriate action in case of delinquency. This management has generally been a weak area in rural banks, with the result that the percentage of nonperforming loans has generally been higher than that in other financial institutions in the rural financial sector in M.P. Poor financial management skills coupled with pressures from various quarters shows to have resulted in unproductive allocation of resources by MP RRBs which in turn is reflected in the high occurrence of NPAs. The customers of MP RRBs compromise of small and marginal farmers, small scale sector, SHG groups, etc, whose credit needs are mostly small. RRBs are not able to cross-subsidize their lending business as they do not usually provide credit to rich borrowers with big needs, so affecting their capacity to earn higher incomes. The reasons for deposits depend on the inflation and the market position. The interest rate is regulated by the RBI guidelines so depending on the level of interest rate is highly influencing factor. It also observed after reviewing the RBI guidelines that the rate of interest is partially fixed after 1977. Hence, the fluctuation has been observed.

SUGGESTIONS & RECOMMENDATIONS

In the light of the findings of the study, the following suggestions are made for improving the performance of the regional rural banks.

- From the findings it is revealed that the bank has adequate capital in terms of total assets. Therefore it is suggested to the banks that they should increase more profits in lieu of the loan disbursement, borrowings, investment in different avenues and also should reduce the liabilities from outside from the customers' perspective.
- In compiling of the data some fluctuations were observed so, it is recommended to the banks they should attract more customers to open their account so that profit per employee may be increased.
- The rural banks should implement certain innovative methods and measures for savings or schemes which suited to the needs of the people in order to attract a large population for making deposits.
- The banks have to give proper attention to reduce the risk ratio. It is suggested to the banks to take care and follow rules and regulations governed by RBI guidelines.
- Further it is recommended that the banks have to control the operating expenses and strengthening the profit of the banks so that the efficiency of the banks in terms of higher profit may be increased.
- The burden for the banks is meeting non-interest expenditure with that of non-interest income. The banks have to plan operations in such a way that non-interest expenditure is fully squared up by the non-interest income.

- The banks should facilitate some more effective schemes to attract agriculture unit.
- As customer services occupies a pivotal place in the rural banks, the banks under study need to develop a greater attention than existing at present on the aspect of customer services and customer research. This opens the golden doors for the prosperous banks.

- There should be a training programme for employees so that they can maintain customer relationship management and able to retain the customers for a ling time.
- During the year, per branch deposit in Madhyanchal Bank stood at Rs. 1275 lacs. The level of low cost deposits in total deposits is 58.83%. To reduce the cost of deposits, branches are paying more attention to increase demand deposits.
- To make more earnings from interest the Bank will continue to give emphasis on agriculture sector and in tune with the changing scenario and to improve the yield on advances, thrust will be given to diversify the lending without diluting the basic obligations of the bank in lending to weaker sections/rural sector.

- The Bank on continuous basis will give due emphasis and priority on recovery of loans and advances. Continuous will follow up and supervision from H.O and R.O by mobilizing the operating staff to maximize their efforts towards recovery drives involving Government officials through recovery camps, have finally will result in recovery with maximation.
- The rural Banks should provide its employees incentives or benefits according to their performances based on the increase of customers and retain them for a long time. This is the best method for retaining their employees and also sustaining the number of customers. Training and development should provide to them so that they can learn to retain their customers and also at the same time they are able to maintain customer relationship management.
- To increase the profit, Banks should reduce their NPAs so that the profitability should be assessed at the fixed point.
- The primary purpose of regional rural banks is to provide quality service to customers is to achieve a broad customer base, loyalty and retention. This means that the banking sector must to strive to be efficient and be able to provide competitive services in order to meet customers’ satisfaction and customers’ perception of value.

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