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AMALGAMATION AND DECCAN GRAMEENA BANK

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ABSTRACT

The Regional Rural Banks (RRBs) were established to cater the rural clientele. Over the years, RRBs have been facing problems due to directed credit and various other controls. Steps have been taken up by the Government Of India to improve their viability. But, the trend of recurring losses continued. In view of this, a policy outcome for amalgamation of RRBs at sponsor bank level was initiated by Government Of India in the year 2005-06. Deccan Grameena Bank (DGB) is one of the bank which was formed after amalgamation of four RRBs sponsored by State Bank of Hyderabad in Andhra Pradesh State. The study is about the achievement of the objectives of amalgamation by the Deccan Grameena Bank. Besides enjoying economies of scale, achieving operational efficiency in administration was the main objective. The bank could succeed in these aspects and could improve its profitability position. In three years of amalgamation, the business of the bank increased by 89.62 per cent, the percentage of Non-Performing Assets to total advances was decreased to 1.77 per cent, the operating cost reduced to 1.26 per cent and the net margin increased to 1.90 percent.

***KEYWORDS**: Regional Rural Banks, Amalgamation, Economies of Scale, Operational Efficiency and Profitability.*

INTRODUCTION

The establishment of Regional Rural Banks (RRBs) in mid-seventies is one of the cardinal wings for agricultural development. They serve the purpose to enquire into the credit requirements of the weaker sections as well as purveys rural credit beneficiaries on a much wider scale. The factors which led for the emergence of RRBs are: the advent of new technology, the spurt in demand for credit and the inability of the cooperative banks to meet

the challenges of agricultural spectrum. Even the nationalized commercial banks are also instrumental for the cause and birth of rural banking.

RRBs, one of the arms of rural banking exclusively meant to cater to the needs of rural clientele, have had a chequered course of radical evolution in its brief span of existence i.e., three decades. There has been no co-relation between the concepts and functions of RRBs which has resulted mismatch between the two over the years, consequently quite a number of problems generated. These problems may be emanating from staff or restrictions on operations. However, the concept of policy makers in setting up of these rural banks has served, specially serving the credit necessities of weaker sections for the farm development with which rural banks have been widely recognized for their invaluable services and these banks remained to continue as an essential parts of banking sector.

Liberalization of economy, market orientation and high competition enhanced the need for the banking organizations to be stronger, vibrant and viable. The reform measures have been extended to RRBs which paved the way for these banks to occupy the driver's seat in the rural banking.

The Internal Working Group on RRBs headed by Shri A.V. Sardesai (June, 2005) examined various alternatives available within the existing legal framework for strengthening and converting RRBs into viable rural financial institutions. The restructuring options given by the group includes

i) Merger / amalgamation

ii) Change of sponsor banks

iii) Balance sheet strengthening

iv) Other options like meeting minimum capital requirements, issues pertaining to governance and management etc.,

The Group is of the opinion that all the restructuring options constitute a comprehensive package of measures and may not yield the desired effect if implemented in isolation.

REVIEW OF LITERATURE

Chandrakanth K. Sonara (1998) assessed the performance of five gramin banks in Gujarat for a decade from 1985 to 1994. The results indicated that out of the five RRBs only one had made a negligible profit of 0.55 lakhs in the year 1985. He had suggested for restructuring of RRBs in order to provide economies of scale and by deploying their financial assets in such a manner, so as to provide them substantial additional income without diverting the focus from agriculture and rural development aimed at the weaker sections.

Advisory Committee on flow of credit to agriculture and related activities, 2004 (Dr. Vyas Committee) recommended for the RRBs in the North Eastern States be merged into a Zonal Bank or standalone basis. A two-step amalgamation of RRBs for the rest of the country.

Under first step, all RRBs of a sponsor bank in a state be amalgamated into a single unit. Under second phase, to form a state level rural bank by amalgamating all RRBs in that state.

The Internal Working Group on RRBs, 2005 (Sardesai Committee) viewed that to improve the operational viability of RRBs and take advantage of the economies of scale, the route of merger/amalgamation of RRBs may be considered taking into account the views of the various stakeholders. The Group has put forth two options: merger between RRBs of the same sponsor bank in the same state and merger of RRBs sponsored by different banks in the same state.

Thingalaya N.K. (2006) in his book "Karnataka: Fifty years of Development", reveals that Grameena Banks in Karnataka compared to those operating in other states proved to be viable rural credit agencies accessible to the weaker sections of the society. He stressed the need for adopting modern practices by the Grameena Banks and has suggested for evolving RRBs as the retail outlets of financial supermarkets, selling the fast moving products such as insurance and mutual funds at competitive prices and have a strong door-delivery wing for the special customers i.e., SHGs and also merger of Grameena Banks as a move towards revitalisation.

AMALGAMATION

The Internal Working Group on RRBs has recommended the route of merger/amalgamation mainly to:

1. Improve the operational viability of RRBs; and

2. Taking advantages of the economies of scale (by reducing transaction cost).

The Group views that the merged entities would have a large area of operation and the merger process would help in strengthening some of the weak RRBs. A two-phase restricting was suggested by the group.

i) Merger between RRBs of the same sponsor bank in the same state; and

ii) Merger of RRBs sponsored by different banks in the same state.

Government Of India initiated the process of structural consolidation of RRBs by amalgamating RRBs sponsored by the same bank within a state in September 2005, in terms of section 23 A of the RRBs Act, 1976. Before amalgamation as on 31st March, 2005 out of 196 RRBs, 166 RRBs earned profit of Rs.902.60 crore and 30 RRBs incurred losses of Rs.154.49 crore. 83 RRBs had accumulated losses of Rs.2715.01 crore. The CD ratio was 52.89 percent, the recovery was 77.67 percent and the gross NPAs stood at 8.53 percent.

As a result of amalgamation, the number of RRBs reduced from 196 to 88 as on August 31, 2008. Thus, under the amalgamation process 145 RRBs have been amalgamated to form 45 new RRBs apart from 43 stand-alone RRBs.

As on March 31, 2009, 82 RRBs were operating in 25 states across 586 districts (Out of 605 districts) in India with a network of 14,790 branches. The business and important financial indicators of these banks are shown in table-1.

The profitability of RRBs is substantially enhanced during 2007-08. This is the result of increase in aggregate income by 20 percent on account of higher interest as well as non-interest income. The CD ratio increased to 60.3 percent and the gross NPAs stood at 5.9 percent. Other financial ratios showed improvement during the year.

TABLE: 1

BUSINESS AND FINANCIAL INDICATORS OF RRBS AT ALL INDIA LEVEL

Indicator	2004-05	2005-06	2006-07	2007-08
No. of RRBs	196	133	96	91
Net Profit (Rs. crore) before Tax	748	510	625	1374
Per Branch Productivity (Rs. crore)	6.6	7.7	9.1	10.7
Per Employee productivity (Rs. crore)	1.4	1.6	1.9	2.3
Accumulated loss as percentage to assets	3.5	2.9	2.5	2.1
Salary as percentage to Assets	2.0	1.8	2.2	1.8
Financial Return (per cent)	8.2	6.6	7.7	7.9
Financial Cost (per cent)	4.6	3.5	4.0	4.2
Financial margin (per cent)	3.6	3.1	3.7	3.6
Risk. Operational and other cost (per cent)	2.3	2.9	3.0	3.1
Net Margin (per cent)	1.3	0.7	0.7	0.6

Source: Report on Trend and Progress of Banking in India 2007-08.

METHODOLOGY

The study is confined to Deccan Grameena Bank (DGB) which was amalgamated in March 2006. The data is collected from the annual reports of the bank. The study is for a period of four years from 2005-06 to 2008-09.

OBJECTIVES OF THE STUDY

The main objectives of the study are

1. To examine the impact of amalgamation on various aspects of the bank.
2. To evaluate the bank in achieving the objectives of amalgamation.
3. To assess the operational viability of the bank after amalgamation.

DECCAN GRAMEENA BANK (DGB)

The GOI issued notification on 24th March 2006 for the amalgamation of four RRBs sponsored by the State Bank of Hyderabad which were operating in four districts of Telangana Region of Andhra Pradesh. Sri Saraswathi Grameena Bank operating in Adilabad district, Sri Sathavahana Grameena bank operating in Karimnagar district, Sri Rama Grameena Bank operating in Nizamabad district and Golconda Grameena Bank operating in Ranga Reddy district were the four RRBs which were amalgamated to form Deccan Grameena Bank with Hyderabad, the capital city of Andhra Pradesh as its head office. On 28th January 2008 Hyderabad (Urban) district has been included in the operational area of Deccan Grameena Bank. However, branches were opened in Hyderabad (Urban) district during the financial year 2008-09.

TABLE: 2

BUSINESS AND FINANCIAL INDICATORS OF DGB

Indicator	2005-06	2006-07	2007-08	2008-09
Net Profit (Rs crore)1	17.45	24.54	38.61	39.89
Per Branch Productivity (Rs. crore)	9.87	12.12	14.13	15.43
Per employee productivity (Rs. crore)	2.73	2.93	3.54	4.42
Business (Rs. crore)	1628	2012	2446	3087
Salary as percentage to assets	1.47	1.16	1.31	1.06
Average Working Fund (Rs. crore)	1166.23	1595.36	1664.59	2375.03
Financial Return (per cent)2	8.78	7.82	8.51	8.04
Financial Cost (per cent)3	5.15	4.78	4.79	5.07
Financial Margin (per cent)4	3.63	3.04	3.72	2.97
Operational Cost (per cent)5	2.06	1.77	1.56	1.26
Risk and other cost (per cent)6	0.55	0.21	0.26	0.11
Miscellaneous Income (per cent)7	0.48	0.48	0.43	0.30
Net Margin (per cent)8	1.50	1.54	2.33	1.90
CD ratio (per cent)	61.00	59.50	69.34	72.41
Recovery (per cent) (June previous	79.00	79.49	85.98	80.64

year)				
Gross NPA (per cent)	4.75	2.89	1.60	1.77

Note:

1. Before appropriation to provisions on rural advances.
2. Percentage of interest earned to average working fund.
3. Percentage of interest expanded to average working fund.
4. Financial Return minus Financial Cost.
5. Percentage of operating expenditure to average working fund.
6. Other costs include amortization of premium on government securities as percentage to average working fund.
7. Percentage of non-interest income to average working fund.
8. Financial margin minus risk, operational and other costs, plus miscellaneous income.

1. IMPROVING OPERATIONAL VIABILITY

The operational Viability is possible by means of

- Increasing the volume of business
- Cutting down transaction cost and
- Minimising bad loans.

Increase in volume of business is possible by lending to emerging avenues such as micro-credit through SHGs, rural non-farm sector, financing of panchayat raj institutions, waste land development, financing cold storage as well as service units, marketing of life and non-life insurance products, payments under social security pensions etc.

As on 31st March, 2008, the bank had made aggregate disbursals of Rs.336 crore (cumulative) in lending to 87204 SHGs. The bank had recorded an increase of 22.8 percent in the number of SHGs financed in 2007-08 over the previous year.

The outstanding advances to rural non-farm sector were Rs.224.94 crore during 2006-07, registering a growth rate 48.49 percent over the previous year 2005-06. However, in the year 2008-09 the same was only Rs.156.03 crore.

Moreover, the outstanding advances to non-priority sector recorded an increase of 36.04 percent in the year 2007-08 over the previous year 2006-07.

To increase the non-fund income, the bank sold 49817 SBI life policies in the year 2006-07 thereby earning 0.08 crore and in the year 2007-08 it earned 0.18 crore from the same avenue. Besides this the bank has entered into Memorandum of understanding with M/s United India Insurance Company Ltd., for marketing of their non life insurance products.

The bank through its 45 branches covering 351 service area villages is implementing a project in partnership with Government of Andhra Pradesh for prompt payments under social security pensions. As on 31st March, 2008, 18,000 beneficiaries were enrolled under this project.

The bank could succeed in introducing new loan products from time to time to meet the needs of the customers in the changing environments. As a result the volume of business of the bank showed a significant improvement after amalgamation. A business growth of 23.60 percent was registered during 2006-07 over previous year 2005-06 and in the year 2008-09 the growth rate over 2007-08 was 26.21 percent.

The improvement in the financial performance of the bank is also reflected in the decline in the NPAs ratio during 2007-08. The proportion of Gross NPAs to total advances declined from 4.75 percent in 2005-06 to 1.77 percent in 2008-09. The trend is indicative of a reasonably good control over NPAs by the bank.

Further, the improvement in cost and margin of the bank as on 31st March, 2009 in comparison to 31st March, 2006 i.e., before amalgamation, is also indicative of the efficacy of amalgamation. The financial margin which was 3.63 percent in 2006 improved to 2.97 percent in 2009. A substantial growth is recorded in net margin from 1.50 percent in 2006 to 1.90 percent in 2009.

The asset quality of the bank has tremendously improved after amalgamation due to its improved recovery performance. The rate of recovery improved sharply from 79 percent during 2006 to 80.64 percent in 2009.

While making strenuous efforts to improve performance, the social content should be taken as the primary criterion in lending the loans which is a basic factor in changing the economic scenario. The RRBs should also ensure that the social responsibility do not uproot the viability of the institution. It is a crystal clear that the lending by RRBs for production credit is to the utmost of gratification of every one but it is realised that there is a marked preference to non-priority advances or other priority advances in place of advances for agricultural investments and non farm sector.

2. ECONOMIES OF SCALE BY REDUCING TRANSACTION COST

The operating cost which was at 2.06 percent in the year 2006 is marginally reduced to 1.26 percent as on 31st March, 2009. The wage bill in proportion to total assets reduced from 1.47 percent in 2006 to 1.06 percent in 2009. The risk and other costs followed the same trend and reduced by 0.44 percent during the same period.

The important components of expenditure such as repairs and maintenance, insurance, depreciation on bank's property and other expenditure reduced after amalgamation, which has contributed to the increase in net profit.

FINDINGS

1. Business turnover increased by 89.62 percent in three years from 2005-06 to 2008-09.

2. The gross NPAs to total advances declined from 4.75 percent in 2005-06 to 1.77 percent in 2008-09.

3. The financial margin improved from 3.63 percent to 2.97 percent in three years.

4. The operating cost reduced from 2.06 percent to 1.26 percent.

5. The net margin substantially improved to 1.90 percent in 2008-09 from 1.50 percent in 2005-06.

TO CONCLUDE

The key indicators mentioned above, point to the operational efficiency attained by the bank after amalgamation. The idea behind the consolidation of RRBs is to make them more competitive, viable and to spread the activities to a wide spectrum of areas. Besides enjoying economies of scale, achieving operational efficiency in administration was the main objective. The bank could succeed in these aspects and could improve its profitability position.

The recent policy, in respect of amalgamation has resulted in significant growth in the financial aspects of the bank. The policy has provided the way for cross subsidization which has increased the business volume as well as out reach of the bank to a great extent.

The first phase of restructuring of RRBs as recommended by the Internal Working Group on RRBs was initiated by the GOI and was proved successful. GOI can take up the work of second phase of restructuring that is amalgamation of RRBs sponsored by different banks in the same state. The formation of state level RRBs would be a welcome move. In such case an independent governance body is to be setup and the share of the sponsor banks should be taken up by the State Governments. At the same time it should be ensured that the identity of RRBs is not lost.

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