The Social Banking Experiment: Studying the Impact of Regional Rural Banks in India

Anirudh Sudhir, Léonie Favre-Tissot, Rohan Saran

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Introduction to Social Banking and RRBs

In the mid-20th century, as a response to the aftermath of the Second World War, the concept of social banking emerged and gained in popularity. It would be hard to give an exact definition to this principle given its variety of historic origins and underlying values. Nevertheless, Social Banking, also called “alternative banking” or “sustainable banking”, can be explained from a broader perspective as banking and related financial services with the main objective of contributing to the preservation of the planet and people. In other words, Social Banking is a form of “bank with a conscience”. It focuses on investing in a community, and most of the time provides opportunities for the disadvantaged while supporting social and ecological agendas. It considers their activities' influence on all levels and has for main goal other than providing financial services, to reduce negative impacts in favour of the creation of a positive and long-lasting outcome. Instead of the usual competitive banking approach that has dominated the banking world in past decades, it focuses on the principle of “cooperative banking”.

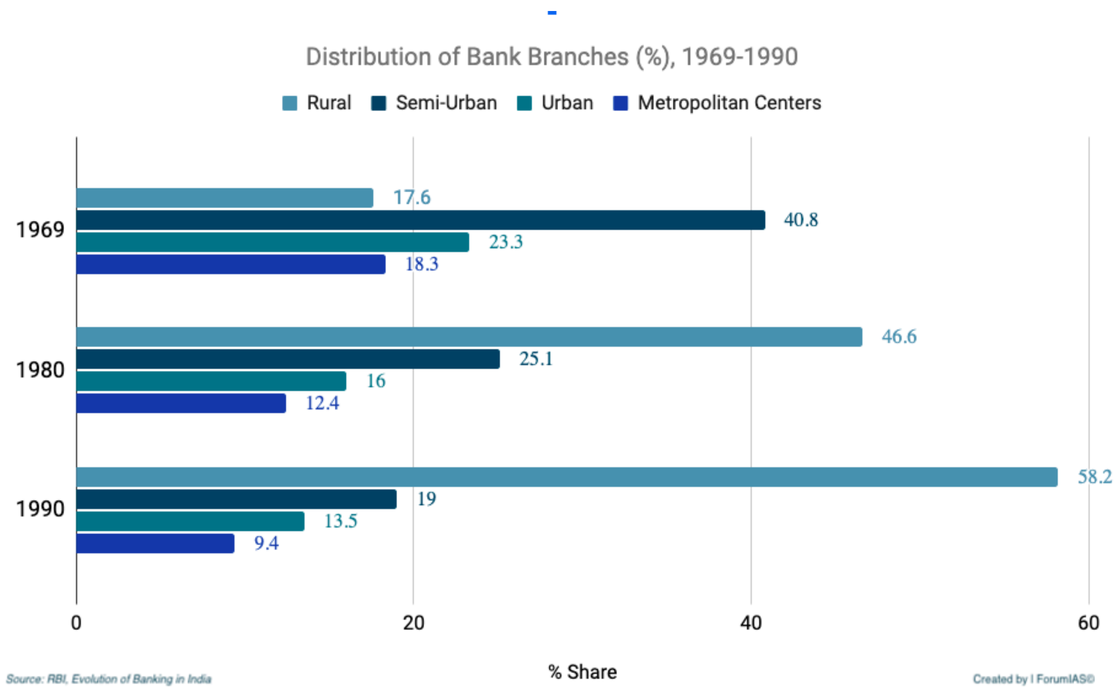
To achieve this, banks must be free from pressure, small, and flexible enough so that they can make decisions quickly. The trust they have in their ideals and borrowers is only made possible thanks to the direct and personal relationships they build with their customers. This is one of the reasons why social banks refrain from becoming publicly listed companies. While their focus is not centred on money and profit as ends in themselves but as means to achieve certain objectives, the main differences with normal banks become obvious. Indeed, mainstream banks are grounded on profit maximization, whereas sustainable banking tends to go beyond this one-sided vision. According to the Global Alliance for Banking in Values, they implement the triple principle of profit-people-planet, where they care about mutual responsibility and know their customers personally, keep track of what is done with the money they lend, and focus more on the long-term effects of the money. Most of their work has as their first goal to develop society by, for example, investing in small projects that may “snowball” into long-lasting positive effects. Certainly, profit is still considered an important aspect, but it is seen more equitably, and used to promote human and environmental well-being. When making decisions, for instance whom to lend money, they take into careful consideration those three aspects.

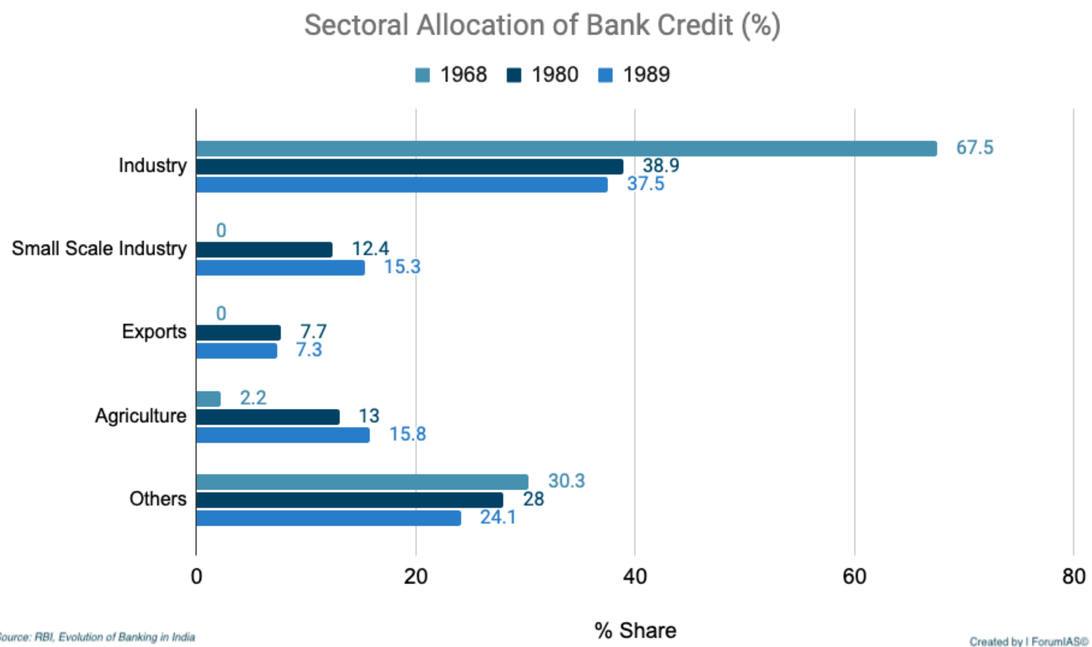
Social Banking in India

India is an emerging country with the world's largest social banking program. Indian banks are required to finance the weaker sectors of society that are excluded from the traditional financial system (priority sectors) while providing mainstream banking services to non-priority sectors. India is largely made up of people living in villages and rural areas. With mainstream banking practices, the poor population is neglected and marginalized, with the quality of the financial services directly hindering the overall expansion and development of the country as a result. At the time of independence, moneylenders and traders exploited small and marginal farmers and landless laborers by lending them money at exorbitant

interest rates and manipulating the accounts. This meant that these poor farmers and laborers, who had no means to pay back this debt, took further loans to pay the money back, keeping them in a debt trap.
The marginalization of the lower classes by the banks left them with little to no savings, crippling debt, and unemployment, prompting the government to think of ways to alleviate this poverty. Seeing this, the government decided to implement the concept of social banking in India in 1969. The main idea behind this was to bring in banking reforms which shifted the orientation of policies towards serving the common mass who made up most of the population. By ensuring easy access to banks and regularised credit, along with lowering the minimum requirements to open an account, the government helped the rural population of the country have access to money, which they then used to expand their land, invest in better equipment, and grow more crops.

The social banking system in India has been developed through three big phases of transition. The first and most significant stage started when 14 commercial banks were nationalized on July 19th, 1969, with the primary objectives being the channelling of savings, allocation of funds to the disadvantaged, and elimination of the monopoly control of private commercial enterprises homes, and corporation families on banks. The aim was to provide help to the neglected sectors, in particular the weaker sections of the society through branch multiplication and Priority Sector Lending by reducing provincial irregularities. In 1975, Regional Rural Banks (RRBs) were established to provide credit and other facilities to small farmers, and agricultural laborers. These RRBs further helped the government achieve the goals they set out when they nationalized the banks in 1969 which is the main part of social banking in India today. The second transitional phase in the development of the social banking system in India occurred during the 1990s when the focus was put on the strengthening of the economic institutions through various reforms of the financial sector. The third and final stage of development happened post-2005, when financial inclusion was broadly practiced on the national level, with emphasis on giving basic banking facilities through no-frill accounts.





Features of an RRB

There are 43 RRBs in India as of 2023, with over 21,856 branches across India. Generally, the banks are owned by three different institutions: the Central Government, the Sponsored Bank, and the concerned state government, with a ratio of ownership of 50:35:15 respectively. The area of their operation is limited to the area notified by the government of India, and it covers one or more districts in the State.

Since they have collective ownership from both the private and public sectors, RRBs can mobilize financial resources efficiently like commercial banks and better understand the rural landscape than other commercial banks due to them being a part of the public sector.
The general aim of RRBs is to provide financial assistance in sectors like Agriculture, Micro, Small, and Medium Enterprises, education, housing, and micro-credit.

The main function of an RRB is to provide loans at low interest rates in Rural areas. They are mandated to assign 75% of their total bank credit to Priority Sector Lending (PSL). The PSL aims to lend to sectors of the economy that the RBI feels require economic assistance and would make immense losses without PSL. The 8 sectors under the PSL are:
(i) Agriculture (ii) Micro, Small and Medium Enterprises (iii) Export Credit (iv) Education (v) Housing (vi) Social Infrastructure (vii) Renewable Energy (viii) Others. The RRBs are also obliged to help those in these sectors outside of just providing them credit. They supply inputs and equipment to farmers, assist in marketing their products, and maintain godowns (warehouses).

Their managerial structure is similar to that of a commercial bank. RRBs have a board of directors, a chairperson, a managing director, a manager, regional managers, and other staff. The RRB also can't extend large or long-term loans to their customers.

RRBs can accept deposits from their bank holders. Deposits can be made of any kind, savings, fixed and recurring forms. In 2023, the RBI announced it had enhanced the bulk deposit limit for RRBs from 15 lakh rupees to 1 crore Rupees.
RRBs balance sheets are extremely similar to those of Public Sector Banks (PSB) and only differ on two fronts: The composition of loans and investments on the assets side and the composition of deposits and borrowings on the liabilities side. From the aggregate balance sheet of RRBs, released by NABARD in 2022, we see their CD (Credit to Deposits) ratio is 60.88%. This is not too far off from the CD ratio of PSBs which was 64%. Since this is an aggregate figure, this does give us the full picture as several RRBs have CD ratios well above 100%, which means they give out more loans than they receive deposits. On the other hand, some RRBs have a very low CD ratio, below 30%. This means that for every Rs100 of deposits, the RRB can only lend out Rs30. RRBs are often referred to as institutions with poor CD ratios since they are obliged to give credit to many borrowers who might not have a good credit history. However, Rural Credit is a public good that has a multiplier effect on the economy. On the liabilities side of things, we see that RRBs have borrowings that make up 11% of all liabilities. Most of their borrowing is from NABARD to facilitate targeted and subsidized lending.

Table 3.1. Aggregate Balance Sheet of RRBs (FY22)

Assets			Liabilities		
	₹ billion	Percentage		₹ billion	Percentage
Loans	**3,425**	**49%**	**Deposits**	**5,625**	**81%**
			Current accounts	120	2%
			Savings accounts	2,944	42%
			Time Deposits	2,561	37%
Investments	**2,957**	**42%**	**Borrowings**	**739**	**11%**
Deposits with sponsor banks	183	3%	NABARD	671	10%
Deposits with other banks	534	8%	Sponsor bank	39	0.6%
SLR securities	2,152	31%	Others	29	0.4%
Non-SLR securities	87	1%			
Fixed and others assets	**248**	**4%**	**Provision & other liabilities**	**197**	**3%**
Cash & cash equivalent	**334**	**5%**	**Capital**	**402**	**6%**
Cash	253	4%	Initial investment	149	2%
Call money / short notice balances	81	1%	Reserves	344	5%
			Accumulated losses	-91	-1%
TOTAL	**6,963**	**100%**	**TOTAL**	**6,963**	**100%**

Source: NABARD (2022)

RRBs also play a key role in carrying out government operations/schemes at the district level. For instance, RRBs are tasked with the distribution of wages of the Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA), which aims at providing up to 100 days of paid unskilled manual work to every rural household with an adult volunteer. As of the 2023-2024 fiscal year, up to 51 million households have benefited from this scheme. RRBs also help distribute pensions provided by the poverty alleviation pension schemes in India.

Akin to Commercial banks, RRBs also provide services like foreign exchange, bill payments, and wire transfers. Utility services like debit and credit card issuance and locker facilities are also provided by RRBs.

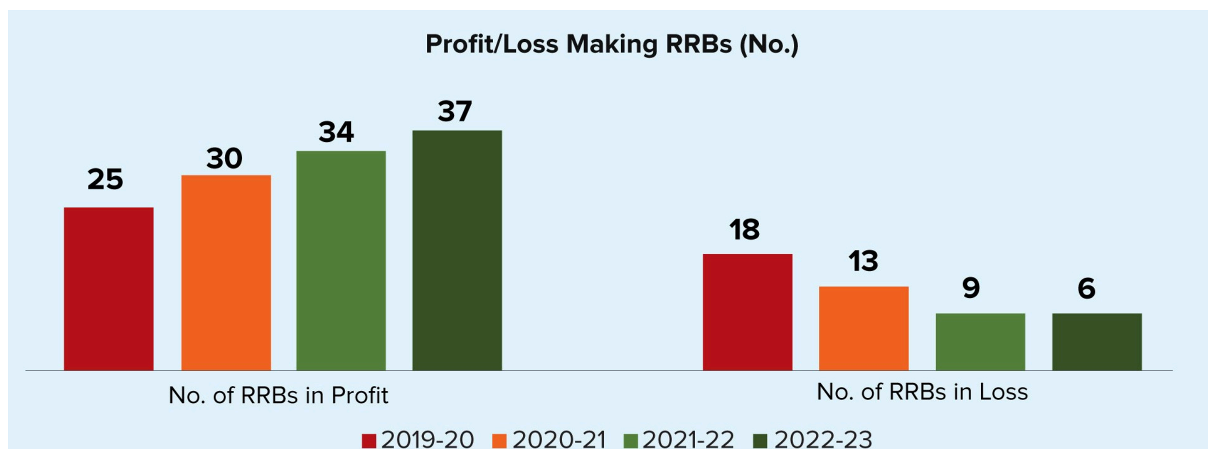
Efficacy of RRBs in India

The government has faced many challenges while ensuring RRBs are efficiently run entities. Initially, RRBs struggled to be financially sustainable for numerous reasons. They had limited activities, focusing mainly on offering government schemes like Direct Benefit Transfer (DBT) in rural areas. DBT is a mechanism used by the government to directly transfer funds to the population that needs financial assistance. There was no repayment of these funds, and RRBs merely served as a means to inform the rural populous about these schemes and oversee their execution effectively. Staying financially sustainable hence proved difficult, as the purpose of the RRBs was to promote and execute these schemes. Combined with the fact that the rural population had little to no savings, their lack of income meant that RRBs depended largely on NABARD for the finances to run their operation, as they received a

pittance in deposits. Additionally, the loans they did end up providing usually turned bad, due to the demographic targeted by the RRBs being extremely poor, as mentioned before.

However, all signs point to RRBs becoming exponentially more effective over the years. The government, which initially focused on establishing an increasing number of RRBs, decided instead to consolidate the main RRBs and increase only the number of RRB branches. As a result, the number of RRBs has reduced from a high of 196 in 2005 to 43 in 2023, with a view to further reduce this number to 36 in the coming years. This move was made with the objective of ensuring "better scale-efficiency, higher productivity, the robust financial health of such banks, improved financial inclusion, and greater credit flow to rural areas", according to a senior Finance Ministry official. Additionally, reducing the number of RRBs serves to reduce the overhead costs, make better use of existing technology and
expand the capital base and area of operation.

This measure seems to have helped, as RRBs have posted the highest-ever consolidated net profit of Rs. 49.74 billion during FY 2022-23. Additionally, the number of loss-making banks has reduced to six out of 43, down from 13 in FY 2021-22, with four long-time loss-making banks posting a profit. Additionally, the RRBs consolidated Capital to Risk Weighted Assets Ratio (CRAR) was at an all-time high of 13.43% as of 31 March 2023. A higher CRAR means that banks have a larger capital buffer as compared to their risk exposures, which indicates greater financial stability and ability to withstand losses. The consolidated Gross Non-Performing Assets (GNPA), which stands at 7.28%, is also the lowest it has been in the previous seven years. RRBs have also improved in their quest to improve tech adoption, which aligns with the central government's view to digitalize the country's economy. All these signs are positive and represent great growth and financial stability from the RRBs.



The funds provided by the RRBs also seem to be going to the intended source, with 70% of the RRB credit flowing through the agricultural sector, and 64% of their credit being targeted towards weaker demographics, including small and marginal farmers, according to the Warehousing Development Regulatory Authority. This further highlights that the financial stability of the RRBs is built off the contributions of the rural agrarian population of the country. The healthy state of the RRBs accounts represents the growth of the financial power

of the rural population, who can utilize the credit extended to them by the RRBs to increase their production and repay the loans in a timely fashion.

All these factors point to RRBs being self-sustaining and financially healthy, which is a direct result of their customer base, the rural population of India, being in a better position financially. A large part of this financial growth can be attributed to the RRBs and the services they provide, buttressing their claim to being a viable option for developing economies to look at as they aim to help their own rural population become more prosperous.

Conclusion

Regional rural banks are a concept unique to India, and their success can prove to be a blueprint for other largely agrarian developing nations that wish to aid their rural population. While these institutions would face several obstacles right after their inception, the RRBs in India have shown that these banks can eventually turn financially sustainable by uplifting the people they serve.

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