Penetration Of Scheduled Commercial Banks In Rural Areas : A Comparative Study

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ABSTRACT

Banking plays a vital role in the growth and development of developing countries like India. Banks lubricate the entire monetary and financial system and ensure smooth operations. With the initiation of the processes of liberalization and globalization of the economy, the financial sector, particularly the commercial banks, not only in urban areas, but also in rural areas were the first to experience the winds of change. However, these changes were experienced more in urban areas than in rural areas. The most pertinent issue today is how well is the rural banking sector positioned to cater to the continued growth of the banking sector as a whole? In India, more than 50 percent of the population is based in rural areas. Though the Indian banks are penetrating the rural areas to meet the rural customers' needs, but still, they have not achieved the set target. In this light, there was a need to evaluate the performance of the banks working mostly in rural areas and compare with those that are not operating, or are involved on a very low scale in rural areas. The present paper throws light on the performance of the Scheduled Commercial Banks that have more branches and fewer branches in rural areas. The paper also highlights the main issues and suggests measures for the banks to penetrate the rural sector so that the Indian economy can grow as a whole.

Keywords: Scheduled Commercial Banks, Private Sector Banks, Public Sector Banks, Foreign Banks, Rural Areas, Credit Deposit Ratio, Net Profitability Ratio and Non Performing Assets (NPAs)
JEL Classification : G21,C19,C82,R51

INTRODUCTION

The banking system is the backbone of a nation's economy. It provides the necessary funds for the nation's growth and development. Banks play a pivotal role - not just of accepting deposits and deploying large amounts of public funds, but also leveraging such funds through credit creation (Sailu , 2010). The Indian banking system has played a crucial role in the socio- economic development of the country. The system is expected to continue to be sensitive to the growth and development needs of all segments of the society. The banking system in India is significantly different from that of other Asian nations because of the country's unique geographic, social, and economic characteristics. India has a large population and land size, a diverse culture, and extreme disparities in income, which are marked among its regions. There is a high level of illiteracy among a large percentage of its population but, at the same time, the country has a large reservoir of managerial and technologically advanced talent. About 30 - 35 percent of the population resides in metros and urban cities, and the rest is spread in several semi-urban and rural areas. In 1977, the government passed a regulation which required both public and private sector banks to open four branches in unbanked locations for every branch. This 1:4 licensing policy was aimed at forcing banks wishing to expand in already banked locations to open branches in unbanked locations (Burgress and Pande , 2003) . In considering the program of expansion of branches in urban centers, the RBI kept in view the need to distribute more equitably, the burden on banks of opening branches between the rural and semi-urban centers on the one hand, and the urban centers on the other. This paper analyzes the performance of some selected public sector, private sector and foreign banks working in rural areas. For this purpose, selective indicators were taken into consideration. This paper tries to conclude that the banks which have more branches in rural areas perform well in terms of Profitability, Credit Deposit Ratio and Non- Performing Asset ratio as they perform in urban or semi-urban areas ; so the banks with lesser or no branches in rural areas should be motivated to penetrate into the rural areas.

REVIEW OF LITERATURE

Avadhani et al. (1987) studied the performance of rural branches of some commercial banks in order to identify the factors influencing deposit mobilization in rural areas in different states. The authors came out with the opinion that

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there existed sufficient relationship between the deposits of a rural branch and its age. The growth of deposits increased at a faster rate in the first six years and tapered off subsequently. It is to be noted that there were no special schemes for deposit mobilization, and no special incentives were given to the bank staff. Yet, each branch management had evolved its own strategy to mobilize deposits in order to achieve the targets fixed by the Head office. Burgress and Pande (2003) studied the impact of regulation regarding the opening of rural branches over the period from 1977-1990. The study found a 1 percent increase in the number of rural banked locations (per capita), which resulted in a 0.42 percent decline in poverty, and 0.34 percent increase in total output.

Nair (1994) examined the rural bank marketing in Kerala and evaluated the products or services offered by banks in rural areas and examined the diversified needs of rural customers in the state through a field survey of 250 rural bank customers in Ernakulum district. The study showed that Proximity, Quick Loan facility and Better services were the three major variables influencing the rural customers for selecting the banks. The faith of rural customers in the nationalized banks was comparatively high. So, they should impart better services to improve their image.

Vradi, Vijay, Maulri and Nagarjuna (2006) evaluated the measurement of efficiency of Indian banks and concluded that in the modern world economy, the performance of the banking sector is of vital importance to stabilize a nation's economy. In order to ascertain the efficiency of Indian banks, four indicators - i.e. Profitability, Productivity, Assets, Quality and Financial management for all the banks including the public sector, private sector banks in India - were studied for the period from 1999-2000 to 2002-2003, as these were the factors influencing the rural customer for selecting the banks. The faith of the rural customers in the nationalized banks was comparatively high. So, these banks should impart better services to improve their image.

Jain (2007) examined the status of NPAs in commercial banks. The study found that the problem of gross and net NPAs was more acute in public sector banks, and foreign banks had also registered an increase in the amount of gross and net NPAs during the period from 1997-2003. It was concluded that the new private sector banks and foreign banks had failed to prevent the fresh generation of NPAs in the period ; whereas, PSBs and old private sector banks were able to reduce it.

Jayachandran and Nagananthi (2008) conducted a study with an objective to evaluate the trend in the Non Performing Assets (NPAs) of State Bank of India and its Associates. The study observed that NPAs for State Bank of India and its Associate banks had significantly declined over the period of the study.

OBJECTIVES OF THE STUDY

1) To study the trends of the selected public, private and foreign banks having more and less number of branches in rural areas.

2) To analyze and compare the performance in terms of Credit Deposit Ratio, Net Profitability Ratio and Non Performing Assets (NPAs) of these selected banks.

3) To suggest various measures for banks to serve the rural areas.

RESEARCH METHODOLOGY

To address the objectives of the study, the Indian banking industry was taken as the universe of the study and the industry was divided into three groups - viz. public sector banks, private sector banks and foreign banks. Further, two banks were selected from the public sector group with more number of branches in the rural areas - State Bank of India (SBI) and Punjab National Bank (PNB); banks with lesser number of branches included IDBI Bank and State Bank of Travancore (SBT) . The banks in the private sector group with the highest number of branches in the rural areas included ICICI Bank and Jammu & Kashmir Bank (J&K), and the bank with the lowest number of branches included Development Credit Bank (DCB) and Kotak Mahindra (KM) Bank . From the foreign sector bank group, the banks with the highest number of branches included DBS and HSBC Bank, and the bank with the lowest number of branches included Deutsche Bank (DB) and Standard Chartered Bank (SCB).

To compare the performance of these banks, selective indicators were taken into consideration. These indicators are distribution of rural branches: bank groups wise, share of banks in terms of financial indicators like Net Profitability, Credit Deposit Ratio and Non - Performing Asset ratio. The study covers the time period of 5 years from 2007 to 2011. Two statistical tools were used to compare the performance, i.e. Averages and Growth.

Table 1: Expansion Of Rural Branches Among The Selected Banks As On 31st March, 2011						
SNo.	Bank Groups	Banks with Highest Rural Branches		Banks with Lowest Rural Branches		Total Rural Branches of the Group
		1		2		3
1	PSBs	SBI	PNB	IDBI	SBT	20387
		4972 (24.38)	1972 (9.67)	81 (0.39)	5 (0.024)	
2	Pvt. SBs	ICICI	J&K	KM	DCB	1311
		260 (19.83)	231 (17.62)	21 (1.60)	4 (0.31)	
3	FBs	DBS	HSBC	DB	SCB	7
		3 (42.85)	1 (14.28)	1 (14.28)	-	
Source: Report on Trend and Progress of Banking in India (2010-11)						
Note: Parenthesis values show percent of bank branches from the total group's branches in the concerned areas						

ANALYSIS AND DISCUSSION OF RESULTS

The selected Banks of all the groups were divided on the basis of the highest and lowest number of branches in the rural areas.

The Table 1 shows that State Bank of India had the maximum number of branches in the rural areas. There were 20387 branches of public sector banks in the rural areas, out of which, 24.38 percent share belonged to SBI, and the lowest share (0.024 percent) belonged to State Bank of Travancore (SBT). Likewise, the private sector group had 1311 branches in the rural areas, out of which, ICICI Bank had the maximum share, with 19.83 percent, and DCB had the lowest share, with 0.31 percent. Foreign banks had only 7 branches in the rural areas, out of which, DBS had the highest share, and Standard Chartered Bank did not have any branch at all.

The Table 2 shows that among the banks in the public sector group, the average CD ratio of SBI was 77.56 %, which was higher as compared to PNB, but the growth rate of PNB was 27.27 percent, which was higher than that of SBI. It shows that three quarters of SBI's deposits were converted into loans. The bank having the lowest number of branches in the rural areas, i.e. IDBI Bank had a high average CD ratio, but SBT had a higher growth rate than IDBI Bank. It means that more than hundred percent of the deposits were converted into loans.

Likewise, in the private sector banks, the average CD ratio of ICICI Bank was more than that of the Jammu and

Table 2: Trends In The Credit Deposit Ratio Of The Selected Banks (Percent)									
Sr.No.	Bank Groups	Banks/Years	2006-07	2007-08	2008-09	2009-10	2010-11	Average	Growth
			1	2	3	4	5	6=(1+2+3+4+5)/5	7=(5-1)/1*100
1	PSBs with HRBs	SBI	77.5	77.6	73.11	78.58	81.03	77.56	4.55
		PNB	60.8	73.9	73.75	74.84	77.38	72.13	27.27
2	PBs with LRBs	IDBI	144.1	112.6	92.02	82.43	87.04	103.64	-39.6
		SBT	79.5	79.6	77.55	75.59	79.77	78.40	0.34
3	Private Banks with HRBs	ICICI	85	92.3	99.98	89.7	95.91	92.58	12.83
		J&K	67.8	66	63.42	61.92	58.63	63.55	-13.52
4	Private Banks with LRBs	DCB	60.2	67	70.46	72.27	76.14	69.21	26.48
		KM	99.3	94.7	106.27	86.97	100.23	97.5	0.94
5	Foreign Banks with HRBs	DBS	32.1	46.4	45.21	60.50	102.5	57.34	219.3
		HSBC	66.5	70.3	55.21	42.11	50.64	56.95	-23.84
6	Foreign Banks with LRBs	DB	70.9	65.1	62.19	87.59	97.59	76.7	37.64
		SCB	88.1	90.2	50.10	57.56	52.49	67.69	-40.42
Source: Report on Trend and Progress of Banking in India (2006-11)									
Note: HRBs means highest number of rural branches, LRBs indicates lowest number of rural branches.									

Kashmir (J&K) Bank, and its growth rate was also higher than that of the Jammu and Kashmir Bank. In this group, the Kotak Mahindra Bank had the lowest number of branches in rural areas, with average CD ratio of 97.5 percent, which was more than that of the Development Credit Bank (DCB) , but the growth rate of DCB was much more than KM. It shows that if ICICI Bank (having the highest number of branches in rural areas) and Kotak Mahindra Bank (with the lowest number of branches in rural areas) had almost similar CD ratios, this implies that both were performing well in the rural areas. Hence, other banks should also follow suit, and should open their branches in these areas so that they can serve more number of customers.

In case of foreign banks, Development Credit Bank (DBS) and HSBC Bank were the foreign banks who had the maximum number of branches in the rural areas. However, DBS had more average CD ratio, and its growth rate was also higher than that of HSBC Bank, whose growth rate was negative. i.e. -23.84 percent. Among the foreign banks operating in rural areas, Deutsche Bank (DB) and Standard Chartered Bank (SCB) had the lowest number of branches. However, Deutsche Bank had a greater average CD ratio and growth rate than the Standard Chartered Bank (SCB). Hence, it can be concluded that banks which had more number of branches in rural areas had a greater average CD ratio and growth rate, except in the case of J & K Bank and HSBC Bank.

Table 3: Trends In Profitability Ratio Of The Selected Banks (Percent)

Sr.No.	Bank Groups	Banks/Years	2006-07	2007-08	2008-09	2009-10	2010-11	Average	Growth
			1	2	3	4	5	6=(1+2+3+4+5)/5	7=(5-1)/1*100
1	PSBs with HRBs	SBI	0.80	0.93	0.9	0.87	0.67	0.83	-16.25
		PNB	0.95	1.03	1.3	1.14	1.17	1.14	23.16
2	PBs with LRBs	IDBI	0.61	0.56	0.5	0.44	0.65	0.55	6.56
		SBT	0.86	0.88	1.2	1.15	1.02	1.02	18.6
3	Private Banks with HRBs	ICICI	0.90	1.04	1.0	0.11	1.267	0.86	40.78
		J&K	0.96	1.10	1.1	1.2	1.22	1.12	27.08
4	Private Banks with LRBs	DCB	0.14	0.51	-1.5	-1.3	0.29	-0.37	107.14
		KM	0.71	1.04	1.0	1.5	1.61	1.172	126.76
5	Foreign Banks with HRBs	DBS	1.22	0.72	2.1	1.44	0.53	1.20	-0.56
		HSBC	1.23	1.56	1.7	0.89	1.67	1.41	0.357
6	Foreign Banks with LRBs	DB	1.54	1.57	1.4	1.57	2.19	1.65	0.42
		SCB	2.32	2.32	2.0	2.4	1.93	2.19	-16.81

Source : Report on Trend and Progress of Banking in India (2006-2011)

Net Profitability to Total Asset Ratio is a financial ratio that shows the percentage of profit that a company earns in relation to its overall resources. It provides information about a bank's performance in using the assets to generate income. The Table 3 shows that the growth rate and average of PNB was more than that of SBI. SBI had a negative growth rate i.e. -16.25 percent. It was due to fluctuations in net profitability ratios. This shows that not more than 1 percent profits were earned from its resources in the last five years. But SBT, with the lowest number of branches in this group, has more average and growth rate of net profitability than IDBI. The profitability ratio of SBT was continuously increasing from 2006-2009, and then it declined to 1.02 percent in 2010-11. In case of the private sector banks, the growth rate of ICICI Bank was more than that of the Jammu & Kashmir Bank, but the average of J&K was more than 1 percent. But KM had an average of 1.71 percent and growth rate of 126.76 percent, which was more than DCB. In case of foreign banks, HSBC had more profitability average and growth rate than DBS, which had an average of 1.20 percent, with negative growth rate of -0.56 percent. It shows that there were fluctuations in their profitability and in case of foreign banks with LRBs, the average of SCB was more than that of DB, but it had a negative growth rate. These facts give mix results i.e. the banks which have more or less number of branches in rural areas have more growth rate with low average, or low growth rate with more average, which makes it clear that rural branches do not have a negative effect on the performance of banks, so the banks with lesser or no rural branches can be motivated to serve these areas for overall economic development.

Table 4: Trend In Net NPAs Ratio Of The Selected Banks (Percent)									
Sr.No.	Bank Groups	Banks/Years	2006-07	2007-08	2008-09	2009-10	2010-11	Average	Growth
			1	2	3	4	5	6=(1+2+3+4+5)/5	7=(5-1)/1*100
1	PSBs with HRBs	SBI	1.56	1.78	0.66	0.90	1.03	1.19	-33.97
		PNB	0.75	0.64	0.17	0.53	0.85	0.59	13.33
2	PBs with LRBs	IDBI	1.16	1.30	0.58	0.91	0.98	0.99	-15.51
		STB	1.08	0.94	0.92	1.02	1.06	1.00	-1.85
3	Private Banks with HRBs	ICICI	1.02	1.55	2.09	2.12	1.11	1.58	8.8
		J&K	1.14	1.07	1.37	0.28	0.20	0.81	-82.46
4	Private Banks with LRBs	DCB	1.64	0.66	3.88	3.11	0.97	2.05	-40.85
		KM	1.98	1.78	2.39	1.73	0.72	1.72	-63.64
5	Foreign Banks with HRBs	DBS	-	0.05	0.55	1.00	0.31	0.382	-
		HSBC	0.43	0.58	1.42	2.31	0.91	1.13	111.63
6	Foreign Banks with LRBs	DB	0.01	0.22	0.88	0.79	0.23	0.426	2200
		SCB	1.43	1.04	1.37	2.31	0.91	1.41	-36.36
Source Report on Trend and Progress of Banking in India (2006-11)									

The measure of Non - Performing Asset helps to assess the efficiency in allocation of resources made by banks to the productive sector. The problem of NPAs arises either due to bad management by banks or due to external factors like unanticipated shocks, business cycle and natural calamities [Caprio and Klingebiel, 1996]. The Table 4 depicts that in PSBs, SBI had an average of 1.19 percent of NPAs with -ve growth rate of 33.97 percent, and PNB had an average of 0.59 percent, which is lower than that of SBI, but the growth rate of PNB was more than that of SBI . In case of LRBs, IDBI Bank had a low average with lesser growth in NPAs than STB, which showed that only a small part of the advances were not recovered. In the private sector banks, J&K Bank had a low average and negative growth in NPAs than ICICI Bank, which showed effective control on NPA recovery. Likewise, KM Bank had low average (1.72 percent) and witnessed a decline by 63.64 percent, which is less than that for DCB. In case of foreign banks, DBS had an average of 0.382, which was less than that of HSBC Bank, but the growth rate was much more than that of DBS Bank. In LRBs, SCB had a greater average than DB, but also suffered a decline of 36.36 percent, which is quite less than it was for DB. This study shows that the banks with the highest number of rural branches had more NPAs - and even registered a growth in NPAs, with the exception of J&K Bank, that succeeded in reducing NPAs ; while the banks with the lowest number of branches in the rural areas witnessed a decrease in NPAs, with the exception of DB, though their average NPAs were larger.

SUGGESTIONS

1) All the banks were performing well in the rural sectors in terms of the CD ratio. The CD ratio of all banks under the three groups was ideal, with an average of 75%, except in the case of IDBI Bank from the public sector group. ICICI Bank and KM Bank from the private sector group had a CD ratio that was more than the average of 75%. The remaining banks performed very well by maintaining the ideal level of CD ratio by following the guidelines prescribed by the RBI. Hence, if the studied banks can perform well, the other banks should also take their example and should penetrate into the rural sector for the benefit of the rural consumers.

2) The Net Profitability Ratio of the entire private sector group working in the rural areas was much better as compared to the public sector group and the foreign banks' group. Kotak Mahindra Bank from the private sector group showed a remarkable progress and achieved a growth rate of more than 100 % . Out of all the three groups, only three banks showed a negative growth rate in terms of Profitability .The first bank was SBI from the public sector group, which had a negative growth rate of 16. 25%. The reason behind the negative growth rate of SBI was its declining profits in two years i.e. from 2009 - 2011 ; then came the DBS and SCB Banks from the foreign sector group, which showed a negative growth rate. But on an average, the profitability of all the banks in the rural areas was higher as compared to the earlier years . Therefore, the other banks should serve the rural areas so that they can tap the untapped resources in this sector.

3) Almost in every group, there was a negative growth rate of NPAs, which is an indicator of their good performance except in the case of HSBC Bank and DB from the foreign sector group, which had a high level of NPAs. These banks should focus upon reducing their NPAs. The remaining banks were performing very well and succeeded in reducing their NPAs to a great extent.

CONCLUSION

Banking in India is fairly mature in terms of supply, product range and reach in rural India. But still, there are more requirements to develop the rural areas. This study concludes in light of the performance of some selected banks having the highest and the lowest number of branches in rural areas. Private sector banks as well as the Zforeign banks have shown a growing interest in entering India's rural areas and have introduced innovative approaches and financial products to serve the rural areas. The Government needs to do what it takes to create an environment that would make it possible and profitable for interested banks to enter the rural areas. The present study shows that almost all the banks performed well in rural areas in terms of CD ratio, Net Profitability ratio and NPA's, so other banks should open their branches in rural areas so that they can serve the customers efficiently. The Government can also play an active role by introducing better laws and regulations, enhanced regulatory, supervisory and legal framework to support the development of rural banking by taking lessons from the banks which are performing very well in the rural areas.

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