



# Regional Rural Banks At Crossroad – Priority Vs. Profitability

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**Abstract:** This paper provides a qualitative and descriptive analysis of the historical evolution of Regional Rural Banks (RRBs) in India, examining the inherent conflict between their foundational mandate of social viability and the subsequent necessity for financial profitability. Employing secondary data from the authoritative sources like NABARD, RBI, and scholarly literature, the study traces the transformation of RRBs through distinct historical phases. The analysis reveals that during the "inception and expansion" phase (1975-1990), RRBs successfully fulfilled their social objective by promoting financial inclusion into unbanked rural areas. Although, this focus led to widespread instability in the financial performance and sustainability of RRBs. In response, a series of structural reforms were implemented to ensure survival. These reforms have encouraged the commercialization, diversification, and expansion of RRBs into more lucrative markets and transformed the systemic losses into significant profits. However, the study concludes that this shift towards profitability has fundamentally altered the operational character of RRBs, causing them to deviate from their original philosophy of social banking.

**Keywords** - Regional Rural Banks (RRBs), Profitability, social viability, Rural Banking, Financial Inclusion.

## I. INTRODUCTION

Regional Rural Banks (RRBs) in India were established with the explicit objective of addressing the credit deficit in rural areas, promoting financial inclusion, and providing support to small-scale farmers, rural artisans, and marginalized communities. Since their establishment in 1975, RRBs have been crucial in the rural credit system by combining the local accessibility of cooperatives with the business expertise of commercial banks. However, in recent times, these banks have arrived at a pivotal point — a crossroads where they must balance their social mission with financial success. On one side, RRBs are tasked to prioritized developmental goals by providing affordable loans to rural and remote areas, often sacrificing profitability. On the other side, they are under growing pressure to maintain financial stability amid evolving regulatory standards, competition from commercial and fintech entities, increasing non-performing assets (NPAs), and the need for technological upgrades. The challenge of choosing between their mandated social duties and the economic necessity of profitability raises significant questions about their future path, operational strategies, and policy backing.

## II. LITERATURE REVIEW

The literature on Regional Rural Banks (RRBs) in India highlights their evolution, performance, and impact on financial inclusion. Misra (2007) documents the historical context, noting the shift towards inclusive banking post-1969 nationalization and the subsequent establishment of RRBs in the mid-1970s as specialized rural financial institutions designed to integrate local understanding with commercial banking professionalism. Several studies focus on the impact of amalgamation and restructuring on RRB performance. Syed Ibrahim (2010) evaluated the impact of the 2005-06 amalgamation, concluding that RRB performance significantly improved in terms of branch network, district coverage, capital funds, and credit-deposit ratio despite a reduction in the number of RRBs. Similarly, Chaudhary & Kaur (2022) empirically

analyzed the impact of amalgamation on RRB profitability, finding a significant increase in Return on Equity (ROE) post-merger, though the impact on Return on Assets (ROA) was less significant, suggesting a marginal overall improvement and noting the positive influence of diversification and credit risk. Pandi (2019) examined RRBs in Tamilnadu from 2007-08 to 2016-17, finding that despite amalgamation leading to fewer RRBs, key performance indicators like branch network, deposits, loans, and net profit significantly increased, enhancing their ability to serve rural populations.

Other studies assess the broader growth and financial performance trends. Barman (2017) focused on RRB performance from 2013 to 2016, anticipating findings of positive growth and improved rural banking services that helped reduce regional disparities. Bollimutha (2024) tracking data from 1975 to 2022, observed steady growth in RRB deposits and advances but a fluctuating credit-deposit ratio, contrasting with the overall banking industry's consistent growth and higher ratio, yet confirming a strong positive correlation between their credit-deposit ratios and suggesting policies for rural financial inclusion could bolster the sector. Addressing ongoing challenges and future directions, Bhavik Barot & Japee (2021) examined factors influencing RRB performance and their role in rural development, underscoring their importance in credit delivery to weaker sections and recommending improvements in micro-credit outreach, technological adoption, and financial inclusion in unbanked areas to enhance their contribution. Collectively, these studies underscore the vital role of RRBs, the generally positive impact of consolidations on their operational metrics, and the continuous need for strategic interventions to address challenges and optimize their contribution to rural financial inclusion and development.

This extensive literature reviews revealed that RRBs has witnessed several strategic and objective oriented measures from its inception to align its prioritized rural financial mandates while maintaining the profitability. Although there is an abundance of research on Regional Rural Banks (RRBs), a notable gap remains in comprehensively addressing the inherent conflict between their dual objectives: achieving social viability through inclusive rural outreach and sustaining financial profitability in a competitive banking landscape. Many existing studies tend to separate these goals, focusing either on operational performance or financial inclusion independently, thus neglecting a critical examination of the trade-offs and mutual influences between them. This identified research gap provides a compelling justification for a study titled **"Regional Rural Banks at Crossroads: Priority vs. Profitability."** The term 'crossroads' perfectly encapsulates the current predicament of RRBs, which are being pushed by policy mandates towards deeper social inclusion (priority) while simultaneously facing market pressures to operate as efficient, profit-generating entities (profitability). By providing a holistic analysis that seeks to harmonize these dual objectives, the research will offer critical insights to ensure RRBs can successfully navigate this crossroads, evolving into institutions that are both socially impactful and financially sustainable for the long term.

### III. OBJECTIVE OF THE STUDY

Based on the extensive literature review and explicitly stated research gap the researcher has defined a set of objectives:

1. To analyse the contemporary performance of regional rural banks through key indicators of both social viability and financial profitability.
2. To identify the key regulatory frameworks of the government which intensify the conflict between the social mandates and financial profitability of RRBs

### IV. RESEARCH METHODOLOGY

This study utilizes a qualitative and descriptive methodology, exclusively in an extensive review of secondary data from authoritative sources such as NABARD, RBI, government publications, and scholarly literature. It examines the viability and profitability dilemma confronting RRBs by employing a thematic and conceptual analysis framework to identify trends in financial performance, institutional reforms, and regulatory changes.

### IV. Expansion of RRBs with the Evolutionary Mandates and foundational Philosophy

RRBs were established on the philosophy of affordable and accessible rural banking approach, following the recommendation of Narasimham committee in 1975. It was the direct intervention to reduce the financial imbalances and rescue the helpless unbanked rural poor from the financial exploitation of pervasive moneylenders. This new establishment for rural areas was necessitated by the incapable existing banking structure; commercial banks were seen to reluctant in rural lending due to risk aversion on the other hand cooperative banks were too under sourced to fulfil the rural credit demand. To combat financial exclusion in rural India, RRBs were established with the mandates of social banking and prioritized rural

development rather than profit maximization. Resultantly, RRBs operational model was tailored according to their founding philosophy; they were restricted to operate only to rural areas, local staffs were ensured to hire for local touch and familiarity with local issues and focused on providing affordable small-scale credit to farmers, artisans, and labourers. This operational approach has increased the formal banking presence in the rural areas through the expansion of rural branch from 17.6 percent in 1969 to 58.2 percent in 1990 and reduced the non-institutional credit sources as well ("Evolution of Banking in India," 2008) . The initial fifteen years of the Regional Rural Banks, from 1975 to 1990, are best characterized as a dynamic "inception and expansion" phase, marked by comprehensive geographical and business growth. Table No. 1.1 depicts the expansion of RRBs in both their geographical footprint and business operations during the first fifteen years.

**Table No.1.1**  
**Expansion of RRBs in its initial Fifteen Years**

(Amount in Crores)

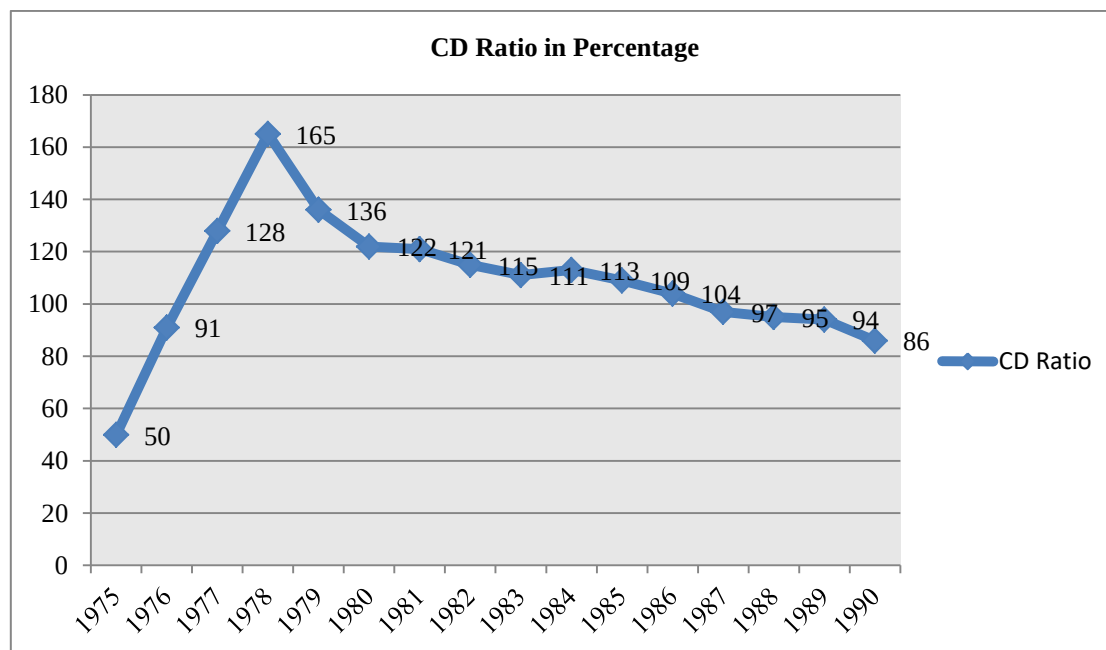
| Year | No. Of RRBs | No. Of Branches | District Coverage | Deposit Outstanding | Advances Outstanding |
|------|-------------|-----------------|-------------------|---------------------|----------------------|
| 1975 | 06          | 17              | 12                | 0.20                | 0.10                 |
| 1976 | 40          | 489             | 84                | 7.72                | 7.02                 |
| 1977 | 48          | 1187            | 99                | 33.04               | 42.35                |
| 1978 | 51          | 1753            | 102               | 74.11               | 122.02               |
| 1979 | 60          | 2420            | 111               | 123.22              | 167.41               |
| 1980 | 85          | 3279            | 144               | 199.83              | 243.38               |
| 1981 | 107         | 4795            | 182               | 336.99              | 406.59               |
| 1982 | 124         | 6194            | 214               | 502.26              | 577.11               |
| 1983 | 150         | 7795            | 265               | 677.85              | 750.84               |
| 1984 | 173         | 10245           | 307               | 959.97              | 1080.77              |
| 1985 | 188         | 12606           | 333               | 1285.82             | 1407.67              |
| 1986 | 194         | 12838           | 351               | 1714.94             | 1784.84              |
| 1987 | 196         | 13353           | 363               | 2305.82             | 2232.26              |
| 1988 | 196         | 14079           | 369               | 2965.88             | 2804.29              |
| 1989 | 196         | 14079           | 369               | 3118.28             | 2918.25              |
| 1990 | 196         | 14443           | 372               | 4150.52             | 3554.35              |

Source: Compiled from Regional Rural Banks Key Statistics

The initial fifteen years of the RRBs were a definitive expression of their foundational social banking philosophy, aimed at providing easy and accessible formal banking services to the unbanked rural poor. This commitment was physically manifested through an explosive expansion of their network; the number of RRBs surged from a mere 6 to 196, while their branch presence expanded from 17 in 1975 to an astonishing 14,443 in 1990. Crucially, these new branches were deliberately established in remote and previously unbanked areas, which granted the first-ever formal banking access to the hitherto neglected rural populace across 372 districts. Financially, the "inception and expansion" period of RRBs successfully mobilize idle rural savings, from a negligible ₹0.20 crores in 1975 to over ₹4,150 crores in 1990. As per to their mandate, RRBs were deployed these funds directly into the rural economy through growing their credit outstanding to ₹3,354 crores in 1990. Interestingly, the entire credit portfolio of RRBs was disbursed exclusively to their target group of small farmers, labourers and artisans within the rural and previously unbanked regions which underscored the RRBs founding philosophy of social banking (Ram, 2015).

The performance of Regional Rural Banks from 1975 to 1990 directly reflects their priority concerns by fulfilling their social development mission. Figure No. 1 reflects Credit deposit Ratio (CD) of RRBs which shows a robust Credit-Deposit (CD) ratio well above the stipulated 60 percent or almost the entire period. The operational performance of RRBs proved that they were true engines for local economic growth. This shows that the funds mobilized from the rural populace were not siphoned off, but were strategically redeployed as credit within those same regions, directly supporting the priority needs of local farmers, artisans, and entrepreneurs in line with their foundational philosophy.

Figure No. 1



### RRBs at Crossroad - Conflict Between the Social Viability and Financial Profitability

The period following the initial operation of Regional Rural Banks created the irreconcilable conflict between their social viability mandate and the pressing need for financial profitability to ensure their own survival. This conflict came into sharp focus when the Khusro Committee report 1989 found that most of the RRBs were financially unviable and perpetually loss-making, the committee even recommended to merge the RRBs with their sponsor banks (Khusro, 1989). The committee's findings revealed that the initial social banking model, with its limited business scope and high-risk, low-return loan portfolio was unsustainable. In response to that, a series of fundamental reforms and measures were initiated, not to dismantle the RRBs, but to make them financially robust. The Narasimham Committee reforms of 1991 were a turning point, triggering a paradigm shift. To improve their financial health, RRBs were permitted to expand into more profitable semi-urban and urban markets, increase their non-target financing from 40% to 60%, and relocate loss-making branches from remote villages to commercially viable market centers. The subsequent Vyas Committee recommendations in 2005 further accelerated this commercialization by promoting mergers of RRBs for operational efficiency and encouraged the diversification of RRBs into more lucrative lending sectors like MSME, housing, and retail loans. Resultantly, the numbers of operating RRBs has also decreased strategically from 196 in 2005 to 43 in 2024. Unintentionally, these reforms pushed the RRBs away from their original purpose.

These structural changes for financial profitability have fundamentally altered the character and operational philosophy of RRBs. The mandate of social banking was gradually superseded by the commercial banking approach and the focus shifted from rural development to profit maximization. Lending patterns has shifted from small, risk-prone loans for marginalized farmers towards larger and safer advances to agri-businesses and MSMEs while maintaining the priority sector lendings. The founding principles upon which RRBs were established such as exclusive rural focus, accessible and affordable credit for the most vulnerable groups in the rural areas were systematically eroded.

The struggle for financial viability forced the RRBs to operate like a commercial bank, although, it contradicts with the foundational philosophy of their establishment. The expansion into urban areas and consolidation in the form of merger and acquisition diminished their unique role and reduced accessibility for the remote rural poor. However, the post-reform period brings a remarkable financial turnaround for Regional Rural Banks. The efficacy of these structural reforms could be seen by the contrast between their past and present performance. Where 173 out of 196 RRBs reported collective losses of ₹259.37 crores in 1992, by FY 2023-24, the landscape had transformed entirely, with 40 out of 43 operational RRBs registering a combined profit of ₹7,571 crores (NABARD, 2024). It can be stated that the pressure to become sustainable compelled the RRBs to divert from their founding principles, transforming them from specialized social banking institutions into more generalized and profit-oriented entities.



## V. CONCLUSION

This article concludes that RRBs are positioned at a critical crossroad, influenced by the persistent conflict between their social mandate and the necessity for financial profitability. During the initial phase (1975-1990), RRBs were effectively achieved their social mission of rural financial inclusion, but at the expense of their financial viability. The subsequent reforms, while facilitating a notable financial recovery and transforming widespread losses into substantial profits, have also led RRBs to deviate from their foundational principles. By adopting a more commercial, profit-oriented model, expanding into urban areas, and diversifying their lending practices, RRBs have fundamentally altered their operational character, thereby dismantle their unique role as specialized social banking institutions. Ultimately, the pressure to achieve financial sustainability has forced the RRBs to divert from their original philosophy. These developments have raised the significant questions about the future trajectory and capacity of RRBs to effectively serve their core, marginalized rural constituency.

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