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EFFICIENCY OF MIZORAM RURAL BANK: A TEST OF FINANCIAL STRENGTH

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Abstract
Mizoram Rural Bank plays a vital role for the development of state economy by spreading all throughout the state. The bank reached many villages with its branch network. The success of rural credit in India largely depends on their financial strength. Profitability became the main consideration and the prime mover of the financial strength and performance of banks. Since profitability is an index of efficiency of a banking enterprise, a profit-making bank can infuse confidence in public at large which is necessary for its survival and growth. Therefore, it is necessary to study the financial performance of Mizoram Rural Bank. This present study is an attempt to evaluate the financial performance of Mizoram Rural Bank during March, 2002 to 2014. The study is based on secondary data collected from annual reports of MRB. Analysis of financial performance by ratio analysis, test of financial strengths, working results of MRB is followed in the present study. The study concludes that the level of operational efficiency of the bank has been increasing every year.

Keywords: Regional Rural Banks, Mizoram Rural Banks, Test of financial strengths, working results of MRB, Financial Performance of MRB and Ratio Analysis.

INTRODUCTION

India is the second most populace country in the world. It has managed to maintain a comparatively high growth rate but still it is not enough for balanced growth of the whole economy. The gap between the ‘haves and have nots’ have been increasing over the time. The real benefits of the growth rate are not reaching to the poor. The access to the formal sources of the finance is very much restricted for poor as they fail to provide collateral. Moreover, the financial services are not conveniently available in the rural areas. This gave rise to the concept of microfinance, but the rate of interest for microfinance is usually high which, in many cases, crosses even 20%p.a. In addition, microfinance sector is mostly controlled by non-government bodies.

Most of the branches of the commercial banks are functioning in the urban area only; the rural people are deprived of the formal sources of finance. Besides, motivating the young generation, particularly in rural areas, towards self-employment has become a universal doctrine but it is rarely thought as how they can be adapted to that pursuit through minimum support. Even the government’s involvement comes to an end by providing subsidy but the transaction of the loan amount remains within the ambit of nationalized banks (Sen, 2012).To address this issue, the Govt of India passed an Act, viz. Regional Rural Bank (RRB) Act, 1976, and established RRBs. The main objectives of RRBs is to provide credit and other facilities for the purpose of development of agriculture, trade, commerce, industry and other productive activities in rural areas, particularly of the small and marginal farmers, agricultural laborers, artisans, and small entrepreneurs. Mizoram Rural Bank was established in the year 1982 under this act.

In order to fulfill the above objectives, a financial institution needs to be financially strong so that it may survive itself and keep advancing loans to the needy persons. Marginal workers, small farmers as well as agriculture labourers of a country who are largely in need of bank finance move from pillar to post in their quest but rarely achieve the desired objective though bank assistance is best suited for them keeping in view their basic needs in accelerated production with an emphasis on infrastructural development. In fact, this sort of financial assistance extended by financial institutions like banks is the core component in all development programmes and also for economic growth of the country (Sen, 2012).

As the profit is the main objective of every business, it is also considered as an important indicator of efficiency in management of bank’s resources. Therefore, profitability can be mentioned as the sin qua non for banking industry. It provides cushion to the bank to support the credit risks and withstand any unforeseeable developments. Profitability became the main consideration and the prime mover of the financial strength and performance of banks. Since profitability is an index of efficiency of a banking enterprise, a profit-making bank can infuse confidence in public at large which is necessary for its survival and growth (Srivastava and Nigam, 2007: 384). However, RRBs practiced an old style to expand their business and thus affected their profitability. Many RRBs in the country are not able to earn a reasonable amount of profit and as a result their viability has been questioned at various levels. As per the Narasimham Committee, the objective of financial institution like RRBs is socio-economic, because of this; the initial period of financial loss may well be a price worth paying for the achievements of larger social objectives of widening the area of credit coverage. Indeed, the success of these banks should be judged as much by the efforts at expanding and extending the area of rural credit, as by conventional yardstick of profitability (Shete and Karkal, 1989: 156-157).

Meanwhile, the Regional Rural Banks have been incurring losses though Reserve Bank of India has granted many concessions, because they are expected to lend to the weaker sections and charge comparatively lower rate of interest. Mizoram Rural Bank has also incurred loss during many years till 2005. It is usually argued that for a socio-economic institution like a rural bank, earning profit should not be the prime consideration. It should be primarily concerned with fulfilling social obligations and promoting development by providing low cost credit to the rural poor. It is popularly known that economic goals and social goals are contrary to each other from such arguments. There is no doubt that social obligations increase cost of operations and adversely affect the profitability of the bank. However, economic goals and social responsibilities are compatible with each other in the long run, in fact, they reinforce each other (Dhaliwal, 2010: 133-134). This present study is an attempt to evaluate the financial performance of Mizoram Rural Bank.

RESEARCH METHODOLOGY

This paper is primarily based on secondary data, which has been collected from various issues of the Annual Reports of the Mizoram Rural Bank. The period of the study is during 2001-02 to 2013-14, i.e. thirteen years. The data so collected from the annual reports has been compiled in relevant tables and has been analysed.

All the banking operations are measured in terms of their ability to generate profit, thus Mizoram Rural bank can also be measured. To show the financial position of the Mizoram Rural Bank, profitability and productivity of MRB have been analyzed on the basis of the following indicators:

Profitability:

1. Interest Earned
2. Interest Expended
3. Interest Spread
4. Net Profit
5. Total Income
6. Total Expenditure
7. Financial return
8. Financial Cost
9. Financial Margin
10. Operating Profit
11. Miscellaneous Income
12. Gross Margin
13. Risk Cost
14. Net Margin

The ratio analysis technique has been applied to calculate various profitability and productivity indicators. Following ratios have been calculated to show the profitability of MRB:

1. Average Interest Earned = Total Interest Earned/ Number of MRB branches.
2. Average Interest Expended= Total Interest Expended/ Number of branches.
3. Average Interest Spread= Total Interest Spread/Number of branches.
4. Net Profit per branch= Net Profit/ Number of branches
5. Average Income=Total Income/Number of branches
6. Average Expenditure= Total Expenditure/Number of branches.
7. Financial Return = (Interest Earned/Average Working Funds) x 100.
8. Financial Cost = (Interest Expended/Average Working Funds)x100.
9. Financial Margin = (Interest Spread/Average Working Funds)x100 or (Financial Returns- Financial Cost).
10. Operating cost = (Operating Expended/Average Working Fund)x100 .
11. Miscellaneous Income= (Miscellaneous Income/Average Working Funds)x100.

12. Gross Margin = (Interest Spread-Operating expenses + Miscellaneous Income)/Average Working Fundsx100
13. Risk cost = (Provisions/ Average Working Fundsx100.
14. Net Margin =(Interest Spread-Operating expenses + Miscellaneous income-Provisions) Average Working Fundsx100

Hypotheses

1. Net interest earned by MRB has been increasing over the year.
2. Total Income earned by MRB has been increasing over the year.

TEST OF THE FINANCIAL STRENGTH

Mizoram Rural Bank, like other banks, borrows money in the form of deposits and lends money as advances to the needy people, especially the rural borrowers. Their main income and expenses are, therefore, interest income and interest expenses respectively. Interest income of the bank depends upon the size of asset portfolio, the rate of interest and the percentage of standard assets. It also includes interest and discount income of the bank. Interest expended relates to the fund raised by the banks. Interest expenditure includes interest paid on borrowing and on deposits. The interest spread is the difference between interest earned and interest expended. It contributes to banks' profit. The spread would be large if the MRB has quality loans and investments to earn income and raise funds at low cost. Thus interest spread is an important indicator of banks' profitability. Table-1 presents the interest earned, interest expended and Interest Spread of the Mizoram Rural Bank for the period March 2002 to March, 2014.

Table 1: Trends of Interest Earned, Interest Expended and Interest Spread of Mizoram Rural Bank (₹`in thousands)

Year	Interest Earned	Interest Expended	Interest Spread*
March, 2002	84,305	45,020	39,285
March, 2003	91,841	53,367	38,474
March, 2004	1,12,243	62,928	49,315
March, 2005	1,21,011	69,454	51,557
March, 2006	1,50,549	78,754	71,795
March, 2007	1,84,880	1,04,764	80,116
March, 2008	2,27,943	1,32,564	95,379
March, 2009	3,06,843	1,72,553	1,34,290
March, 2010	3,80,001	2,26,761	1,53,240
March, 2011	5,23,812	3,16,048	2,07,764
March, 2012	7,06,612	4,43,011	2,63,601
March, 2013	8,88,539	5,43,749	3,44,790
March, 2014	11,18,543	6,06,257	5,12,286

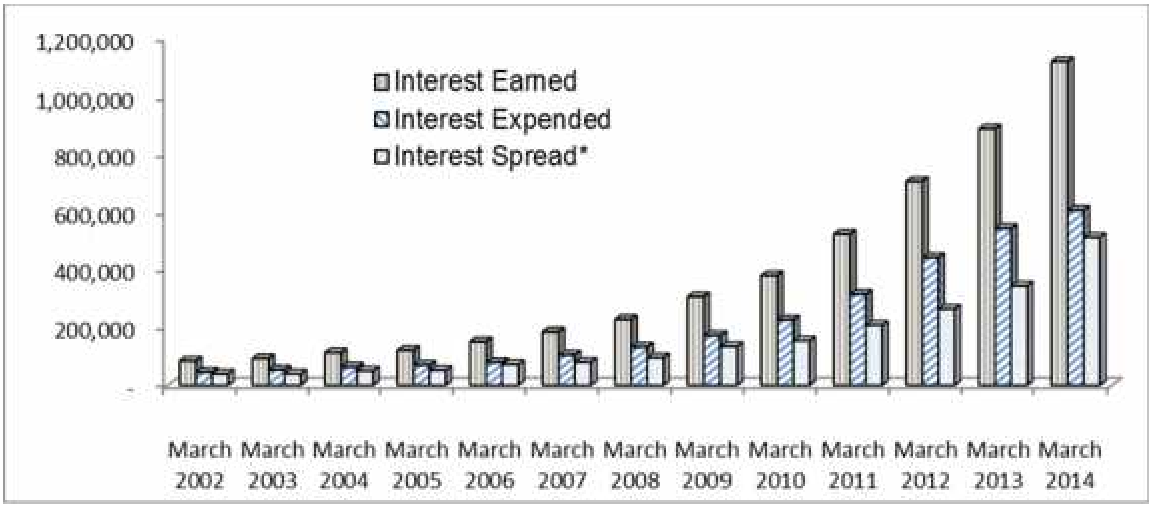
Source: Various issues of Annual reports of MR, 2002 to 2014.

** Interest Spread is calculated by taking the difference between Interest Earned & Expended.*

Table 1 reveals that the interest earned by the Mizoram Rural Bank is remarkable and has an increasing trend during the period of the study. At the end of March, 2002 the total interest earned was `₹843.05 lakh, i.e. every branch earned interest of `₹ 15.61 lakh approximate (54 branches) during the year. The total interest earned by MRB remarkably increased upto ₹

11,18,5.43 lakh as on 31st March 2014. The average interest earned per branch is around ₹ 149.13 lakh during the same period registering almost 13 times growth over the period of 13 years.

Exhibit-1: Interest Earned, Expended and Spread



Source: Various issues of Annual reports of March, 2002 to 2014.

Table-1 also shows that the interest expended by the Mizoram Rural Bank has grown every year from₹ 45,020 thousand in March, 2002 up to₹ 6,06,257 thousand in March, 2014. While the interest expended in the year 2002 be recorded around ₹ 8.34 lakh only, and the amount of ₹ 11,185.43 lakh expended by the bank at the end of March, 2014, which registered a growth of over 13 times over the period. The amount spent by each branch has made an enormous growth during the study period.

The table further indicates that the interest spread for the Mizoram Rural Bank increased from mere₹ 392.85 lakh in March, 2002 to₹ 5,122.86 lakh in March, 2014, registering a growth of over 13 times during the study period. Interest spread per branch at the end of the year 2001-02 was ₹ 7.27 lakh whereas it improved to the amount of ₹ 68.30 lakh each branch at the end of March, 2014. The performances of MRB in interest earned, interest expended and interest spread is remarkable.

WORKING RESULTS OF MRB

Profit is a financial measure of any organization for a specified period. Like any other commercial banks, the efficiency of MRB may also be judged by its profitability. Profit is a function of income and expenditure. The difference between total income and total expenditure is also known as Net Profit or Net Loss. The Net profit represents the surplus of total income over total expenditure over a period whereas the Net loss represents the deficit of total income over the total expenditure. In banks, the total income is sum of interest income on loans, income from investments, fee income or service charges and other incomes. Other income includes income arising out of balance sheet items such as dividend from investments, etc and off-balance sheet activities such as commission on letter of credit etc. Total expenditure of a bank is sum of interest expenses, provisions for loans and operating expenses, etc. Similarly, the value of total profit or loss (accumulated) is taken after the deduction of income tax, to be paid by the bank, from the sum of total net profit and profit brought by the bank in the previous year. If the loss is higher than the profit from the result, loss is being incurred in the business (see Table 2).

Table 2: **Total Income, Total Expenditure, Net Profit and Total Profit of MRB (`₹ in thousands)**

Year	Total Income for the year	Total Expenditure for the year	Net Profit/Loss for the year	Total Profit/Loss (Accumulated)
March, 2002	88,913	85,481	2,916	-55,825
March, 2003	95,042	92,126	3,432	-55,809
March, 2004	1,21,111	1,17,238	3,873	-51,936
March, 2005	1,25,958	1,28,927	-2,969	-54,905

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March, 2006	1,62,207	1,60,176	2,031	-52,874
March, 2007	2,19,641	2,12,290	7,351	-46,973
March, 2008	2,59,491	2,42,041	17,450	-35,259
March, 2009	3,21,869	2,84,443	37,426	-9,639
March, 2010	4,19,250	3,62,957	56,293	+28,596
March, 2011	5,63,277	5,15,272	48,005	+62,089
March, 2012	7,41,041	6,63,278	77,763	+1,16,036
March, 2013	9,17,506	8,11,670	1,05,836	+1,87,723
March, 2014	11,54,513	9,06,678	2,47,835	+3,51,173

Source: Compiled Annual Reports of MRB from March, 2001 to March, 2014.

Table 2 displays that total income of MRB increased from ₹ 889.13 lakh at the end of March, 2002 to ₹ 11,545.13 lakh at the end of March, 2014. The average income is calculated from the division of total income by number of branches in Mizoram. At the end of March, 2002, the average income per branch was mere ₹ 16.46 lakh which increased upto₹ 153.93 lakh per branch in March, 2014. Likewise, the total expenditure has grown every year during the study period. The total expenditure of ₹ 854.81 lakh in March, 2002 increased upto ₹ 9,066.78 lakh in March, 2014. The average expenditure per branch is calculated by dividing total expenditure by number of branches. The average expenditure per branch in at the end of March, 2002 is ₹ 15.83 lakh which increased to₹ 120.89 lakh at the end of March, 2014. These results showed that the operational efficiency of MRB has been improving over the period of the study.

Unlike many other RRBs in India, MRB has not incurred net losses. The net profit of ₹ 29.16 lakh in March, 2002 goes up to₹ 2,478.35 lakh in March, 2014 registering a growth of more than 84 times during the period of thirteen years. Like many other RRBs, MRB continued its business with loss till 2009. The total loss of MRB has decreased year after year, i.e. from ₹ 558.25 lakh in March, 2002 to ₹ 96.39 lakh in March, 09. The average loss per branch was ₹ 10.33 lakh in March, 2002 which reduced to ₹ 1.60 lakh in March 2012, thereafter Mizoram Rural Bank is running in profit. MRB registered total profit of ₹ 285.96 lakh at the end of March, 2010 which further increased upto₹ 3,511.73 lakh in March, 2014. The average profit per branch in March, 2010 was₹ 4.68 lakh which improved to₹ 46.82 lakh at the end of March, 2014. This shows that the bank made remarkable achievement as compared to the previous seven years since 2009 (see exhibit -2)

Exhibit 2: **Trends in Net profit and Total profit of MRB**

Source: Compiled from various issues of Annual Reports of MRB during March, 2002 and, 2014

FINANCIAL PERFORMANCE OF MRB VIS-A-VIS RATIO ANALYSIS

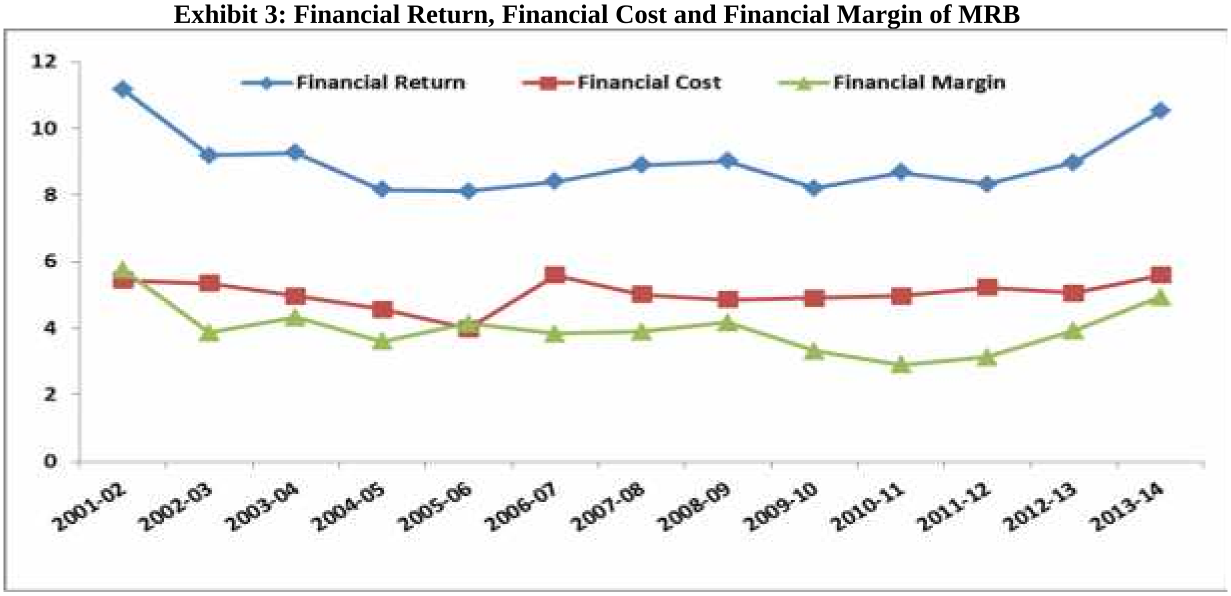
The most important factor of risks and returns can be clearly seen from the overall performance of the bank. Usually interest rate risk is carried on by the bank. Interest rate risk can be found by measuring financial margin. Financial margin shows the rate at which a bank generates interest income out of its assets. It can also be called interest yield per rupee of asset. The difference between financial return and financial cost is financial margin. Financial return represents the interest earning capability of the bank assets. It is measured by the ratio of interest earned to average working funds. Greater the financial return, greater would be the efficiency of a bank. Thus, the financial return has a direct relationship with the financial efficiency of a bank. Financial cost is inversely related to the financial efficiency of the bank. It refers to interest expended as percentage of average working funds. Thus, financial efficiency is measured through financial ratios by relating income and cost streams to average working funds. Higher positive value of financial margin signifies higher financial efficiency. A negative value of financial margin means financially inefficient concern (*Dhaliwal, 2010).* Exhibit 3 shows the financial return, financial cost and financial margin for the period during 2001-02 to 2013-14.

Table 3: Trends in Important Financial Ratios of MRB (in percent)

Year	Average working Funds	Financial Return	Financial Cost	Financial Margin	Operating Cost	Misc. Income	Gross Margin	Risk Cost	Net Margin
2001-02	8,30,941	11.18	5.43	5.75	4.23	0.38	1.90	-	1.90
2002-03	9,99,636	9.19	5.34	3.85	3.81	0.32	0.36	0.07	0.29
2003-04	13,28,964	9.26	4.95	4.31	3.16	0.67	1.82	0.92	0.90
2004-05	15,22,213	8.15	4.56	3.59	2.88	0.32	1.03	-	1.03
2005-06	19,74,820	8.11	3.98	4.13	2.64	0.59	2.08	1.07	1.01
2006-07	22,85,929	8.40	5.58	3.82	2.67	0.95	2.10	-	2.10
2007-08	27,39,984	8.89	5.00	3.89	2.53	0.72	2.08	-	2.08
2008-09	35,57,267	9.01	4.85	4.16	2.10	0.01	2.07	1.08	0.99
2009-10	46,30,055	8.20	4.90	3.30	1.92	0.85	2.23	1.02	1.21
2010-11	65,57,950	8.68	4.96	2.88	2.02	0.53	2.47	1.63	0.84
2011-12	84,82,037	8.33	5.22	3.11	2.23	0.41	1.29	0.37	0.92
2012-13	104,33,665	8.97	5.05	3.92	1.59	0.28	2.05	0.86	1.19
2013-14	128,56,628	10.51	5.59	4.92	1.69	0.28	3.51	0.31	3.20

Source: Compiled from various issues of Annual Reports of MRB during March, 2002 and, 2014

Exhibit 3: Financial Return, Financial Cost and Financial Margin of MRB



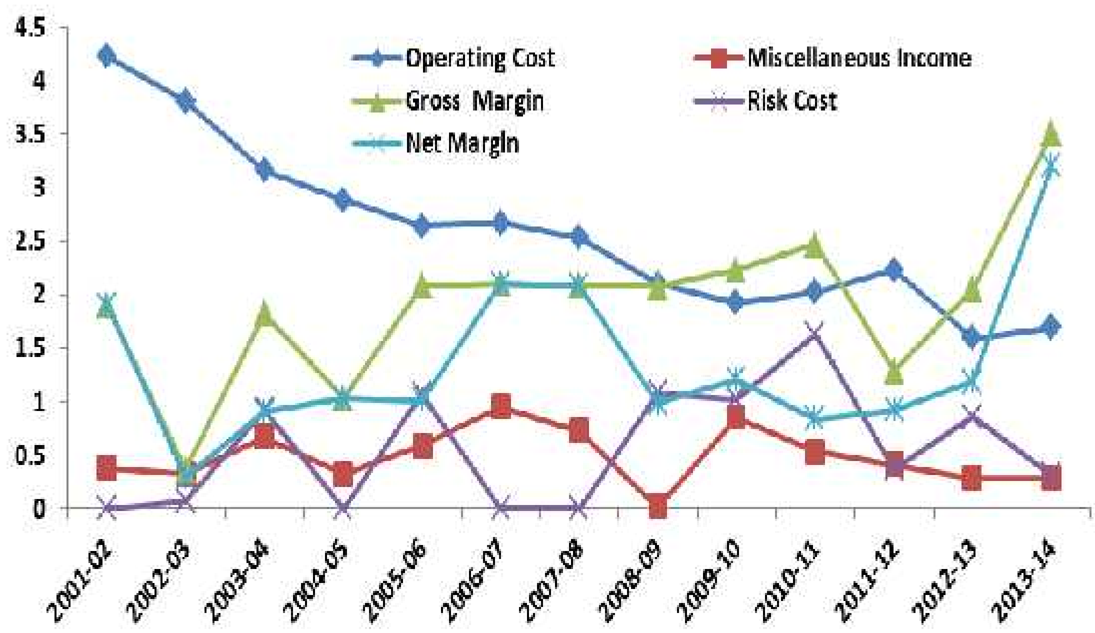
Source: *Compiled from various issues of Annual Reports of MRB during March, 2002 and, 2014*

The table 3 highlighted that the financial return of MRB has decreased from 11.18 per cent in 2001-02 to 10.51 per cent in 2013-14. Even the financial cost has also decreased from 5.43 per cent in 2001-02 to only 3.98 per cent in 2005-06 but again it goes up to 5.59 per cent at the end of financial year 2013-14. Likewise, the financial margin decreased from 5.75 per cent to 4.92 per cent during the same period. These results highlighted that MRB needs to take steps to achieve higher percentage in future.

Gross margin is one of the most important indicators of the operational efficiency in the bank and it is used to determine the working of the bank. It is obtained by adding miscellaneous income to the financial margin and subtracting there from the operating cost. The operating cost is also known as transaction cost. This shows the operating expenses as percentage of average working funds. Operating expenses include salaries, rent, administrative costs and other such expenses. While miscellaneous income includes income from commission, brokerage, exchange and other such receipts. A bank can increase its gross margin through increase in miscellaneous income and savings on operating costs. Thus, the lower level of transaction cost and higher level of miscellaneous income lead to higher gross margin and reflect greater operational efficiency. Further, higher level of gross margin contributes to higher net margin and higher profitability.

The banks usually intend to remove the loan losses and used to make special provisions for this purpose. Such provision is considered as an important component in the total expenditure of a bank. Thus, the level of provisions has direct impact on the profits of a bank and affects risk to the profitability of the bank. So risk cost is recognised in banks and is measured by relating provisions made to the average working funds of the bank. The surplus of gross margin over risk cost gives the net margin. Thus, a higher level of risk cost has adverse impact on the financial efficiency of the bank. As the risk cost reduces the net margin is being generated by the banks. Net margin shows efficiency of the bank in recovering its costs. It shows the efficiency of the bank in using its resources thus reflects net profitability. Exhibit 4 shows operating cost, miscellaneous income, gross margin, risk cost and net margin of MRB for the study period, i.e. 2001-02 to 2013-14.

Exhibit 4: Operating Cost, Miscellaneous Income, Gross Margin, Risk Cost and Net Margin of MRB



Source: Compiled from various issues of Annual Reports of MRB from 2001-02 to 2013-14.

As it is seen from the exhibit- 4 and table-3, Operating cost of the Mizoram Rural Bank has been slowly decreasing from 4.23 per cent in 2001-02 to 1.69 per cent in 2013-14. Meanwhile, the miscellaneous income of MRB has a little bit decreased to 0.28 per cent in 2013-14 from 0.38 percent in 2001-02. During 2001-02 and 2013-14, the percentage of miscellaneous income has changed every year and it increased most of the year under the study. These two results revealed that the MRB has improved its operational efficiency over the period.

As gross margin indicates the operational efficiency of the bank, miscellaneous income as percentage of average working fund is added in financial margin and operating cost is subtracted to obtain gross margin. The growth of gross margin indirectly related to the operational efficiency of a bank. The gross margin of the Mizoram Rural Bank was positive throughout the study periods. From 2001-02 to 2004-05, the gross margin could not surpass 2 per cent mark while it remained higher than 2 percent since 2005-06 onwards except for the year 2011-12. Whereas the risk cost represents the provisions made as per cent of average working funds. During the years 2001-02, 2004-05, 2006-07 and 2007-08, no provision was made. Excluding the four years (i.e. 2002-03, 2003-04 and 2011-14), the risk cost was recorded higher than one per cent mark. The surplus of gross margin over risk cost makes the net margin. The higher level of net margin means the higher profitability. The net margin of MRB in 2001-02 of 1.90 per cent reduced to 0.92 per cent in 2011-12. In the years 2006-08 and 2013-14, the net margin exceeded 2 per cent. This shows that despite the bank seems to be efficient in the management system and it has to improve its performance to get higher profitability in the future.

TEST OF HYPOTHESIS

1. Net interest earned by MRB has been increasing during the period of the study, thus the first hypothesis of the study is being accepted (See table-1).
2. Total Income earned by MRB has been increasing every year during the period of the study, thus second hypothesis of the study is being accepted.

CONCLUSION

The above discussion about the financial strength of MRB, though losses have been incurred in some financial year, it can be seen that its financial position is quite good till date. This result also shows that the level of operational efficiency of the bank has been increasing every year. At the same time, the bank still has a long way to go for future in order to achieve their objectives. Therefore, the rural people can enjoy the banking facilities more than before.

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