

**THE AILING BANKING SECTOR :
A SEARCH FOR A REMEDY**

By

NEENU JOSEPH

Dissertation submitted to
National Law School of India University, Bangalore,
in partial fulfilment of the requirements
for the award of degree of
Master of Laws

DECLARATION

I hereby declare that this Dissertation is written by me during the period of my study at National Law School of India University, Bangalore.

The work in this Dissertation is original, except for such help taken from such authorities, as has been referred to at the respective places. This work has not been submitted either in part or in whole, for any degree at any University.

Bangalore

Dec. 1994


(NEENU JOSEPH)

ACKNOWLEDGEMENTS

My acknowledgements are due to many persons without whose cooperation and academic assistance, the present study would not have been carried out successfully.

First of all, I would like to thank the Director, members of the faculty, library staff, non teaching staff and students of National Law School of India University, Bangalore, who have helped me in some way or the other in the study.

I am specially grateful to Dr. N.L. Mitra and Prof M.P. Pillai for their useful suggestions.

I would also like to sincerely thank Mr. K. Thanu Pillai, Ex Managing Director, State Bank of Hyderabad who has spent time answering my queries and whose invaluable suggestions went a long way in shaping this thesis.

I am also grateful to Mr. Wilson David and Mrs. Suja Wilson for computerizing the report.

Last but not the least, I wish to express my gratitude to my husband, Capt. Mathew George, whose support went a long way in the completion of this thesis.

Bangalore

Dec. 1994.

(NEENU JOSEPH)

TABLE OF CONTENTS

Declaration

Acknowledgements

PART - I

1.1 Statement of the problem	1
1.2 Significance of the study	3
1.3 Objectives of the study	4
1.4 Methodology adopted	5
1.5 Universe of the study	6
1.6 Plan of work	6

PART - II

2.1 Achievements of Banks in the post nationalisation period	8
--	---

PART - III

3.1 Issues and Reforms	23
3.2 Pre-emption of Funds	37
3.3 Priority Sector	49
3.4 Problems of Bank Recoveries	64
3.5 Crime in Banks - Frauds	73
3.6 Autonomy of Indian Banks	88
3.7 Supervision and Regulation	98
3.8 Mechanisation and Computerisation	109
3.9 Customer Service	120
3.10 Closure of unviable Bank Branches	130
3.11 Capital Adequacy	140
3.12 Asset Classification, Income Recognition and Provisioning	150
3.13 Proposal for New Banks in the Private Sector	162

PART - IV

4.1 Performance - Foreign Banks vis-a-vis Indian Banks	175
--	-----

PART - V

5.1 Performance of Banks in 1992-93	183
-------------------------------------	-----

PART - VI

6.1 Conclusions and Suggestions	195
---------------------------------	-----

BIBLIOGRAPHY

INTRODUCTION

1.1 Statement of the problem.

The banking system serves a vital intermediary role in a market oriented economy by allocating a scarce resource, capital to its most efficient and productive uses. Finance is the key to investment and hence to growth. Efficient financial systems help countries to grow, partly by mobilising additional financial resources and partly by allocating those resources to the best use.

As a rule banking systems are adapted to the structure and needs of the particular economy they exist in. Indian economic policy has been founded on the philosophy of economic growth with social justice.

A major developmental objective in this country has been the building up of a financial infrastructure geographically wide and functionally diverse to help in the process of resource mobilisation and to meet the expanding and emerging needs of a developing economy. The prime focus of attention has been the banking system and the nationalisation of banks in 1969 was seen as the major step to ensure that timely and adequate credit support would be available for viable productive endeavour. Announcing the objectives of nationalisation pursuance of the Government's policy of achieving maximum economic growth with social justice and self reliance, that P.M, Mrs. Indira Gandhi, observed " An institution such as the banking system which touches and should touch the lives of millions has necessarily to be inspired by a larger social purpose and has to subserve national priorities and objectives".¹

In consonance with this policy the banking industry embarked upon a new phase of social banking requiring reorientation of credit policy. The Indian banks were called upon to assume a great variety of new responsibilities in the area of social banking for which there are no precedents in the history of modern banking in the world.

Quantitatively, what the Indian banks have achieved in a period of less than a quarter century has very few parallels in the history of banking development anywhere in the world.

Unfortunately, this very size has contributed to the present malaise of commercial banks. Simply put, banks found it difficult to operate keeping in view both socio economic criteria and commercial consideration. Several distortions have crept into the financial system over the years. There has been a decline in productivity and efficiency of the system and in consequence a serious erosion of its profitability even to the point of raising doubts about the viability of some important constituents of the system. This erosion of profitability has adversely affected and continues to affect the ability of the system to expand further its range of services. Banks have also suffered because their quality of loan portfolio has deteriorated, customer service has been poor, work technology remains outdated, fraudulent and corrupt practices have increased, non-performing assets have risen, dominance of trade unions as also political and bureaucratic interference at every stage.

Thus, the future of banks particularly the nationalised banks at no time is as uncertain and shaky as it is now.

All this calls for a drastic overhauling of the banking system. The idea is to create an environment to improve productivity and reduce costs and thereby create a healthy and competitive banking system in the country. The major thrust is to improve the operational and allocative efficiency of the system, by gradually doing away with many of the exogenous and structural factors affecting the performance of banks. Banks must become efficiency conscious and focus on balancing profitability with liquidity while also servicing the necessary socio economic objectives of the development efforts.

1.2 Significance of the Study

The commercial banking system in India will face a series of challenges in the coming years due to rapid changes taking place in the financial, fiscal, trade and industrial sectors. As a part of the new economic policy, the country has embarked upon a massive programme of stabilising the economy and simultaneously undertaking measures to bring about structural adjustments to achieve better macro economic balances and sustainable economic growth. The pace of reform and change has been unprecedented with the proclivity being towards the gradual opening of the economy. From operating in comfortable shores of protected markets and predominant role in the country's economy, banking is entering into choppy waters of intense competition and volatile atmosphere. In this changing scenario banks have to develop adequate dynamics to meet the new challenges and avail of the emerging opportunities. They have to respond by bringing about discernible changes in their productivity and efficiency patterns. Ultimately, an efficient financial structure can be built up only if the banks provide the necessary response.

In this context, we are witnessing a move away from banking driven overwhelmingly by social priorities to one that is driven by market forces. The emphasis is being laid more on viability of the system than in meeting social obligations. Inevitably, profits and profitability will become the key words in the banking sector in the years to come, bringing fundamental changes in the complexion of Indian banking as it is now known. Hence banks need to react appropriately by striving to achieve significant increases in their productivity , efficiency and profitability. Towards this end, the basic objective should be to survive, survive with growth and growth with profits. The banks which are unable to keep pace with changed times and respond quickly to fast changes will be left behind in the race or just vanish.

For banks to survive and grow strongly it is inevitable that they restructure and reposition themselves if they are to be winners in the new era as we move away from a placid environment which posed few threats for banks.

Since it is internationally acknowledged that an efficient banking system is a sine qua non for any nation's economic success, the improved functioning of the banking sector therefore is a necessary pre-requisite for the overall improvement of the economy.

1.3 Objectives of the study

1. To study the existing structure of banks and to give suggestions for improving the efficiency and effectiveness of the system.
2. To critically evaluate the functioning of banks with particular reference to profitability of commercial banks.

3. To ascertain the effectiveness of banks in responding to the emerging credit needs of the economy.
4. To identify the difficulties and limitations faced by banks in its operation due to the control exercised by RBI.
5. To study the role played by banks in promoting the economic objectives of the nation.
6. To study the existing supervisory arrangements in banks and suggest modifications.
7. To make suggestions for modernising work technology and improving systems and procedures of banks.
8. To suggest measures for improving the quality of services by banks.
9. To review the Narasimhan Committee Report and its effect on the banking industry.
10. To make a comparative study of Indian banks viz - a - viz Foreign banks.

1.4 Methodology adopted

In order to achieve the above mentioned objectives, a comprehensive methodology was worked out. In the background of empirical investigation and theoretical rationale, this study analyses the problems and suggests a few of the corrective measures. The study atomises some of the multi - faceted problems concerned with the functioning of banks. The study is based on various sources.

The doctrinal part consists of :-

1. An analysis of the articles in various academic journals as to the ills plaguing the banks.
2. A study and evaluation of the legislative and administrative control on the functioning of banks.
3. A study of the reports of the Government appointed agencies in India that have looked into

the problem.

4. A review of articles appearing in newspapers and magazines.

The empirical study has been conducted through interviews and discussions with

1. Bank Executives.

2. Bankers and Union members.

3. Legal Advisers.

4. Legal Academics and Economists.

1.5 Universe of the study

When the study was first initiated I had limited my scope to one bank, namely the State Bank of Hyderabad. Since the head office of SBH is in Hyderabad, I decided to conduct my study from there. But as my work was progressing I realised that confining my research to just one bank would not have brought out the true picture of the ailments of the banking industry and moreover SBH is a profit making bank.

Hence I widened the scope of my research so as to include the SBI and its subsidiaries as well as the 20 nationalised banks to understand the problems faced by the banking industry as a whole. I continued my studies at Hyderabad as adequate research facilities were available there.

1.6 Plan of Work.

The first part deals with the achievements of the banks in the post-nationalisation period. The second part examines some of the issues affecting the banking systems. The third part compares the functioning of Indian banks with that of the Foreign banks. The fourth

part deals with the performance of banks after the reforms initiated by the Government were implemented. The **fifth part** which is the conclusive part gives a few of the corrective measures.

NOTES

1. H.R. Suneja, " Practice and law of Banking ", (1992), P 32.

ACHIEVEMENTS OF BANKS IN THE POST NATIONALISATION PERIOD

India inherited in 1947 an economic and financial system conditioned by the limited horizon of the then Government's economic policy not attuned to the problems of a developmental nature. The spontaneous political reaction soon after independence was the nationalisation of the RBI in 1949, an assurance by the new Government that the central banking institution of the country would have the commitment to serve the social and economic objectives laid down by it.

The crucial role that the banking system can play to foster institutionalised savings and channel funds in desired directions was recognised in the first plan which emphasised that the banking system had to be fitted into the scheme of development to make the processes of saving and their utilisation "socially purposive". The system was disorganised through serious post war bank failures and needed to be stabilised, strengthened and consolidated. While this was being undertaken by RBI through acquisition of extensive powers of supervision and control under the Banking Regulation Act 1949, it was felt that the Imperial bank of India the premier banking institution should be nationalised, as the preamble to the SBI Act, 1955, puts it, " for the extension of banking facilities on a large scale, more particularly, in the rural and semi-urban areas and for diverse other public purposes ". The structure of public sector banking was further strengthened in 1959 through the establishment as subsidiaries of the State Bank of India, the banking institutions associated with the Governments of the erstwhile princely states.

During the midsixties, the AICC recommended social control of banks as a via

media between complete nationalisation and the maintenance of the status quo. The term social control refers to a greater participation of banks with effective state guidance in the mobilisation of deposits and the distribution of credit to the socially desirable sectors of the economy.¹ The long term objectives of social control of banks was the development of the banking system on the lines of regional banks which would be not only in a better position to mobilise deposits in rural and semi urban areas but would assess and meet the needs of small entrepreneurs and agriculturists in these areas.² It aimed at a radical transformation of banks, their organisation, and lending policies.

Subsequently, in July 1969, government acquired direct control over a substantial segment of the banking system, signifying its commitment to reshape the banking system " to meet progressively and, serve better, the needs of the development of the economy in conformity with national policy and objectives"³.

The nationalisation of 14 major commercial banks in the country is one of the most significant economic steps in the process of banking reforms initiated since independence. The principal objectives of nationalisation were to effect a geographic extension of banking facilities, utilise bank finance and expertise to promote even regional development, provide extensive credit to the weaker sections and small borrowers so that the banks might be an effective weapon of change for more rapid economic growth on a broader base.⁴

The post-nationalisation period witnessed a complete reorientation of Indian banking from class banking to mass banking, from asset based lending to production oriented lending and from elite banking to social banking.⁵

The banking industry has made remarkable progress during the last two decades. Through rapid branch expansion, it has made a dent on the rural credit system by partially displacing the omnipresent money lenders. The proliferation of industrial activities in different parts of the country is accentuated by bank finance. The innovative programmes introduced by the bank have enabled them to build up a very large clientele including those from the poorer sections of the society. Quantitatively, what the Indian banks have achieved in a period of less than a quarter century has very few parallels in the history of banking development anywhere in the world.

However, before evaluating the performance of the nationalised banks during the post-nationalisation era, it would be imperative to have a look at the scenario at the time of nationalisation.

As at the end of April 1969, there were 617 towns out of 2700 in the country which did not have the facility of commercial banks.⁶ As much as 444 towns did not have even cooperative banking services.⁷ Among the various states, the bank credit was spread unevenly to the extent that two major cities Bombay and Calcutta alone accounted for 32% of the total deposits and 52% of the total credit.⁸ The credit deposit ratio was above 89% in the centers where population was above 10 lakhs and it was nearly 40% in the centre where population was less than 10 lakhs.⁹ In 63 districts, per capita was less than rupee one and there was also vast variance in the credit deposit ratio.¹⁰ The national average of credit deposit ratio was 69%. In 23 districts it was more than 100% whereas in 31 districts it was less than 5%.¹¹

Nationalisation was an attempt to minimise the wide disparities in the matter of banking facilities among the various segments of the economy. It was designed to make the system reach out to the small man and to the remote rural areas and to extend credit coverage to sectors hitherto neglected by the banking system and through positive affirmative action provide for such expansion of credit to agriculture and small industry in place of what was regarded as a somewhat oligopolistic situation where the system served mainly the urban and industrial sectors and where the grant of credit was seen to be an act of patronage and receiving it an aspect of privilege.¹²

As the extension of the geographical spread of banking was given prime importance both as an instrument for deposit mobilisation on the one hand and purveying credit especially in the rural areas of the economy on the other, attention was focused on branch expansion. The number of commercial bank branches have increased from 8262 branches in 1969 to 61435 branches in June 1993 which is nearly a seven fold increase.¹³ The result of this expansion has been a sharp increase in the density of banking coverage as reflected in the sharp fall in the number of people served by a banking office. While in 1969 each office served 65000 of the population, the figure is now down to 12000.¹⁴ Today nearly 57% the total bank offices are in rural areas and more than 18% at semi urban centers.¹⁵ Thus three out of four branches are in rural areas. The fact, that many of these offices are in remote areas lacking basic infrastructure shows the devotion of banks and the spirit behind serving for social cause. In 1969 five states namely Maharashtra, Gujarat, Tamil Nadu, West Bengal and Punjab accounted for 46% of the total number of offices. By March 93, the share of other states had risen to over 67%.¹⁶

PERFORMANCE OF PUBLIC SECTOR BANKS
POSITION AS ON JUNE 1969

(Rs.in Crores)

	Offices	Deposits	Credits	C:D Ratio
Rural	1832 (22.4)	145 (3.1)	54 (1.5)	37.2
Semi-Urban	3322 (40.1)	1024 (22.0)	407 (11.3)	39.7
Urban	1447 (17.5)	1209 (25.9)	722 (20.0)	59.7
Metropolitan	1661 (20.0)	2287 (49.0)	2426 (67.2)	106.1
TOTAL	8262 (100)	4665 (100)	3609 (100)	77.4

Figures in brackets indicate % to total.

POSITION AS ON MARCH 1993

(Rs. in Crores)

	Offices	Deposits	Credits	C:D Ratio
Rural	35301 (57.6)	40672 (14.8)	23156 (14.0)	56
Semi-Urban	11417 (18.6)	52437 (19.1)	23591 (14.2)	45
Urban	8628 (14.1)	62389 (22.8)	33011 (19.9)	52
Metropolitan	5889 (9.7)	118570 (43.3)	86078 (51.9)	72
TOTAL	61235 (100)	274068 (100)	165836	60

Figures in brackets indicate % to total.

Source : Indian Express, Oct 12, 1993.

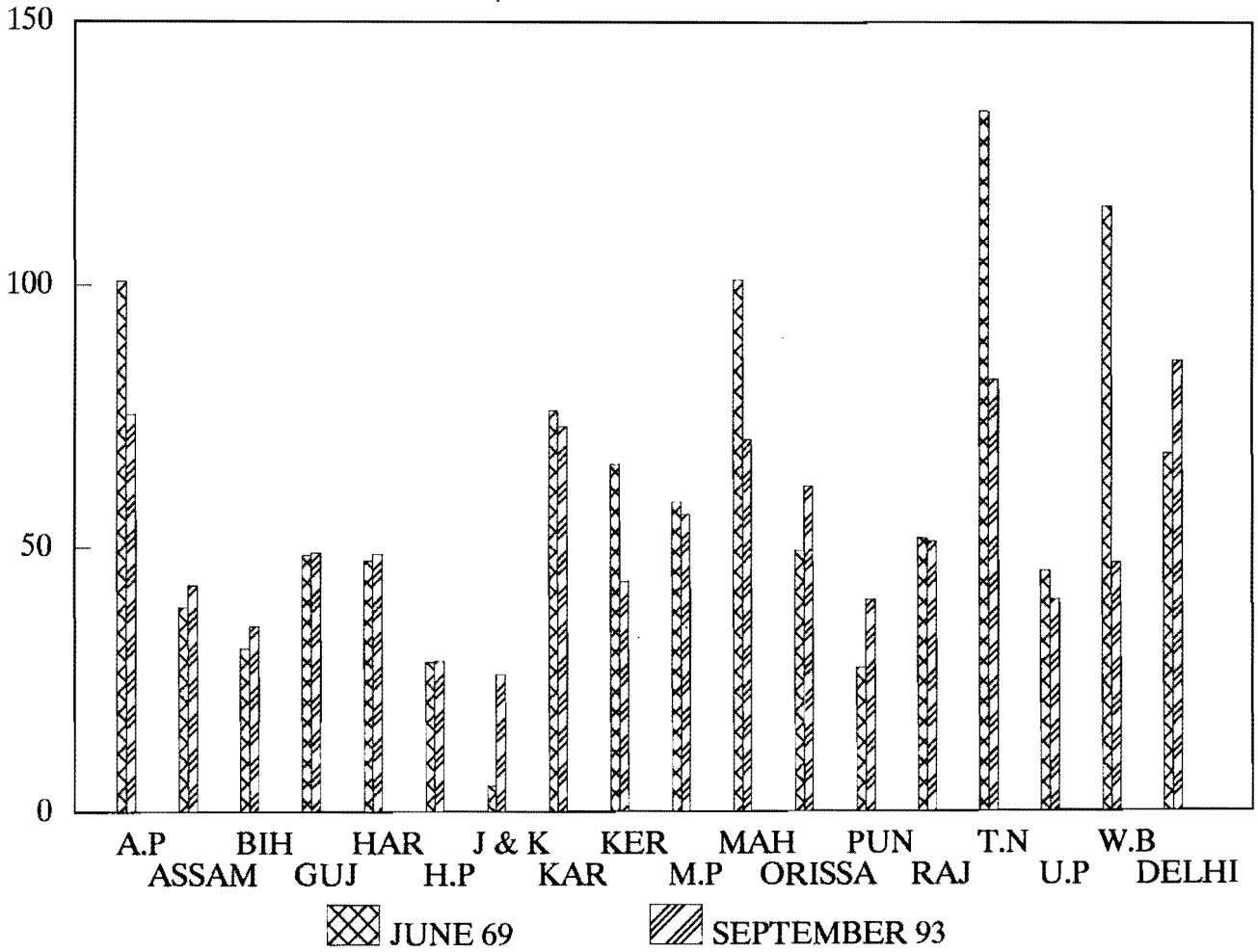
Development of banking infrastructure on such a gigantic scale has helped to inculcate banking habit among the people, as a result of which business of banks has shown tremendous increase during the period since nationalisation. Thus aggregate deposits of banks increased from Rs. 4623 crores to Rs. 265678 crores at the end of March 93.¹⁷ In 1969 aggregate deposits of the banking system constituted about 14% of national income.¹⁸ Over the last two decades the share of aggregate deposits increased a little over 44% of national income as at the end of March, 93.¹⁹ The spurt in the ratio was mainly on account of greater monetisation of the economy and active involvement of the banking system in the day to day life of the common man.

Between the beginning of June 1969, and end of March 93, Rs.45 crores new demand deposits were opened at the banks branches.²⁰ The significant point here is the paramount increase in the share of rural deposits viz from 3.1% in 1969 to nearly 15% in March 93.²¹ Today annual growth of rural deposit is much more than urban specially in the relatively developed states. Aggregate deposits of commercial banks have risen from 13% of GDP in 1969 to approx. 37% during 1994.²²

Likewise, bank credit has gone up from Rs. 3285 crores to Rs. 154899 crores at the end of March 93.²³ The pattern of deployment of bank credit into various segments of the economy indicates a greater shift from urban orientation to rural. The share of rural credit was just 1.5% in 1969 which now stands at 14%.²⁴ In contradiction to this the share of credit to urban elite has been brought down to 71% from over 87%.²⁵

The spread of credit deposit ratio among the various population

CREDIT DEPOSIT RATIO (% OF PUBLIC SECTOR BANKS : MAJOR STATES



SOURCE : ECONOMIC TIMES (BOMBAY), MARCH 23, 1994

groups advocates the much needed importance attached to the rural sector. This ratio in case of rural areas has increased to nearly 57% from 37% in 1969 signifying that the savings mobilised from rural channel were deployed to this sector.²⁶ During the period under review the per capital bank credit has increased from nearly Rs.85 in 1969 to more than Rs.2000 in 1993.²⁷ (Details as per Chart and Graph).

The concept of priority sector came to be evolved in India in the late sixties to focus attention on the credit needs of certain neglected sectors of the economy particularly in the rural areas and to ensure adequate credit facilities to them. The priority sector covers agriculture, small scale industries, setting up of industrial estates, road and water transport operators, retail trade, small business professionals and self employed persons, education and consumption loans etc. which had hardly any access to the banking system prior to nationalisation. For ensuring a progressively increasing flow of bank credit into these desired sectors of economic activity, conducive to the production of goods and services useful to the community, targets for lending were laid down. In September 1979 public sector banks were asked to lend at least 33-1/3% of their total credit to these designated priority sectors and this target was raised to a minimum of 40% to be achieved by March 1985.²⁸ As a measure of further social justice, separate sub-targets within the specified priority sectors were prescribed which are²⁹

1. 40% of total bank credit to the priority sectors by March 1985.
2. 10% of total bank credit or 25% of priority sector credit to the designated weaker sections such as small and marginal farmers, landless labourers, share croppers, etc. artisans and village and cottage industries and beneficiaries of IRDP and DRI schemes.

3. 15% of total bank credit by way of direct finance to agriculture by March 1985, 16% by March 1987 and 17% by March 1989.
4. Direct advances to the weaker sections in agriculture and allied activities (i.e small and marginal farmers and landless labourers) should reach a level of at least 50% of the total direct lending to agriculture (including allied activities by 1983).
5. Advances to rural artisans, village craftsmen and cottage industries should constitute 12.5% of the total advances to the small scale industries by 1985.

These sectors accounted for no more than 14% of aggregate bank credit at the time of nationalisation; in respect of agriculture the figure was 5% which itself was the result of a large but somewhat unplanned step up in agricultural credit by the commercial banks in the two years that preceded nationalisation.³⁰

The figure for priority sector lending has now reached the current target of 40% of aggregate bank credit with the incremental ratio for such credit in the total being much higher. A significant part of the expansion in the priority sector has been in respect of agriculture, where the credit extended has increased from Rs 162 crores in July 1969 to Rs 19884 crores at the end of March 1993.³¹ The share of agriculture and allied activities in the total credit increased from 2.2% in March 68 (of which the bulk was to large tea and coffee plantations which were commercialised Industrial Ventures) to 18% in March 93.³² Consequently the share of bank credit to large and medium Industries declined from 60.6% in March 68 to 30.5% in March 93.³³

The amount of priority sector advances increased significantly from Rs 441 crores in June 1969 to Rs 34874 crores in June 1989.³⁴ As a result of stress on weaker sections, the number of borrowing accounts of Public sector banks increased from 2.6 lakhs as at the end of June 1989 to 46374 crores by end of March 1992.³⁵

The introduction of lead bank scheme with its later modification as service area approach has also contributed significantly to the banks involvement in rural lending. The Gadgil committee appointed by the national credit council in 1968 found that by the end of June 1967, only 5000 villages out of about 6 lakhs, could secure limited credit facilities from commercial banks.³⁶ In about 30% of the total credit requirements of agriculture met by institutional credit agencies, the commercial banks share accounted for less than one percent.³⁷ The study group therefore recommended that the main aim of future national policy should be to involve the commercial banking system in providing rural credit. It recommended the adoption of "area approach" to development.³⁸

All the districts in the country, other than the metropolitan areas, were allocated among the public sector and a couple of private sector banks in which the designated bank was expected to play the lead role. The lead bank had no monopoly but it was primus inter pares. In conjunction with other banks operating in the district and with the help of the local government officials the lead bank identified locations for setting up branches in the district, identified credit gaps and prepared district credit plans to provide credit support to varied economic activities in the districts. The lead bank scheme provided the much needed institutional support to bring about banking development of the allotted districts. The phenomenal growth of commercial banks in terms of the number of

branches opened since 1970 would not have been possible in the absence of the lead bank scheme. Of late, its importance has been enhanced in the implementation of the 20 point programme, the integrated rural development and other anti poverty alleviation programmes. At the end of April 89, 445 districts had been allotted to 22 banks in the public sector, including three banks in the State Bank group and one private Bank.³⁹ While the results achieved in this programme are not uniform through out the country, there are enough evidences to show that the banks have been able to augment the flow of rural credit.

Implementation of the Government sponsored poverty alleviation programmes is another area where the banks have proved their capacity to handle social banking besides commercial banking. Among these operational programmes, banks play a lead role in providing finance to beneficiaries covered under Differential Rate of Interest schemes, IRDP, SEEUY, SEPUP and SFPP. These are target oriented programmes implemented by various agencies and banks have been directed to release finance to these schemes.

The Differential Rate of Interest Scheme, operative since 1972 was intended for the benefit of the weaker sections of the community. The scheme envisaged lending by banks at a concessional rate of 4% per annum to selected low income groups who deserved financial assistance.⁴⁰ The main criteria for selection are the weak economic status of the borrowers as exemplified by those who do not have any tangible security to offer nor can produce a security or guarantee, of a well to do party, and the productive character of the activity to be financed. The important categories of borrowers are landless persons and persons with small holdings, persons who work largely on their own and do not employ paid employees on a regular basis, institutions for physically

handicapped persons, orphanages, womens' homes etc.

The Integrated Rural Development Programme is a major instrument in the strategy to alleviate rural poverty. Its objective is to enable selected families in rural areas to cross the poverty line. This is achieved by providing productive assets and inputs to the target group. The assets which could be in the primary, secondary and tertiary sectors are provided through financial assistance in the form of subsidy by the Government and term credit advanced by financial assistance, primarily by banks. Commercial banks have been the principle agents of IRDP implementation through their branch network. They have looked upon the IRDP as an opportunity to take banking to the many millions of poor in rural area and have made earnest endeavours to contribute to its success. They are however, conscious of the fact that the credit disbursal under the programme has to be speeded up and have rededicated themselves towards this end and have geared up their organisation to fulfill their commitments.

The Self-Employment Programmes for Urban Poor (SEPUP) has been in operation since September 1986. It aims at providing self-employment opportunities to the poor living in the metropolitan, urban and semi-urban centers. Under the programme, one beneficiary for every 300 of population (as per 1981 census) is to be assisted up to a maximum limit of Rs 5000 per family, at a rate of interest of 10% per annum.⁴¹ A family to be eligible for assistance under the programme should have a monthly income not exceeding Rs 600.⁴² The programme is being implemented by selected branches of the public sector banks in all cities and towns with population over 10000 and even in places with a smaller population where IRDP is not in operation.⁴³

Under the Self-Employment of Educated Unemployed youth (SEEUY) scheme some two to two and a half Lakhs educated unemployed youth in the country were provided every year with a package of assistance by way of bank loans and Government subsidy to undertake gainful self-employment ventures in industry services and business beginning with the current financial year (1983-84).⁴⁴

Combining Government subsidy and bank credit these programmes have brought about remarkable changes in rural India. Attempts have also been made to introduce sophistication to banking business through computerisation, establishment of specialised branches and diversification into merchant banking, portfolio management, factoring or housing finance. All banks have not ventured into these new fields. It is too early to assess the achievements made in these areas, as the bitter experiences of the scam-related losses are haunting the bankers.

What has been achieved is indeed unique. No other banking system has achieved such remarkable diversification and expansion within such a short period. The system has had to grapple with complexities of servicing diverse sectors; the obligation to support poverty alleviation programmes in rural and agricultural sectors involving substantial administrative and supervising costs, the obligation to cater to the sophisticated needs of the emerging high-tech industries, the obligation, as one sees today, of seeing through the process of transition of the traditional industries poised for technological upgradation and the equally important obligation to nurse the sick units with rehabilitation packages with reliefs and concessions.

If the above achievements are analysed in pursuant to the broad objectives of the bank nationalisation, it is beyond doubt that many of them have been achieved at least in quantitative terms. However, while looking at the other side of the banks concerning to their efficiency, productivity and profitability etc. one does not find the picture that rosy.

The rapid expansion of branch network, hitherto in remote areas with minimal and no basic infrastructure, social and development banking has placed severe strain on the organisational and managerial capabilities of banks. This led to a chain of problems. While on the one hand, the costs of funds have gone up, on the other the return on their assets has not risen commensurately. At the same time, the rise in non-performing assets has increased the cost of funds of banks. This has placed strain on profitability. Concurrently, it affected the quality of customer service, increase in overdues and poor recoveries, spread of industrial sickness. Organisationally, the management has become very weak before the organised unions and associations. Monitoring and housekeeping has been very inadequate. This led to increase in frauds, rampant corruption and growth of self-seekers and showmanship.

This necessarily calls for radical changes in the policies and priorities in tune with changing domestic and external economic scenario. The policy which proved as useful in the circumstances of the seventies and eighties may not fit in the present environment. It does not mean what has been done was not desired, it was absolutely necessary to come to this stage. However, the phase is over and now it is time to accelerate efforts and gear up the operation of banks matching with the growing needs.

The liberalised policies pursued by the government during the last couple of years have paved the way for the growth of banks in totally different dimension. The process of globalisation of the Indian market and a turn in the operations of global financial markets calls for a change in the shape of the Indian banking system in terms of organisation, operation and administration.

NOTES :

1. Vasant Desai, "Indian Banking - Nature and problems", (1991), P 35-37.
2. Ibid.
3. Preamble to the Banking Companies (Acquisition and Transfer of Undertakings Act, 1970).
4. Supra, n. 1 at 38-41.
5. "24 Years on Bank Nationalisation", Statesman (Calcutta), July, 1993.
6. Kanhaiya Singha, "24 Years of Bank Nationalisation", Indian Express (Bombay), Oct 12, 1993.
7. Ibid.
8. Ibid.
9. Ibid.
10. Ibid.
11. Ibid.
12. Report of The Commission On The Financial System, (M. Narasimham, Chairman), Nov, 1991, P. 8.
13. D.S. Dahotre, "The future of the Indian banking system would be for the performing banks", IBA Bulletin, P. 18, Jan 1994.
14. Supra, n. 6.
15. Ibid.
16. Ibid.

17. Supra, n. 13.
18. Ibid.
19. Ibid.
20. Supra, n. 6.
21. Ibid.
22. Ibid.
23. Ibid.
24. Ibid.
25. Ibid.
26. Ibid.
27. Ibid.
28. R.Srinivasan, "Balancing Social banking with profitability", 59 J.1.1.B 37 (1988).
29. Ibid.
30. Supra, n. 12 at 12.
31. Supra, n. 13 at 19.
32. Mohan .N. Patted, "A rough ride ahead for Indian banks", Financial Express (Bombay), Dec 29, 1993.
33. Ibid.
34. I.Satyasundaram, "Mounting pressures on profitability", Financial Express (Bombay), April 22, 1992.
35. Supra, n. 5.
36. Supra, n. 1 at 150-171.
37. Ibid.
38. Ibid.
39. Ibid.

40. Id. at 431-432.

41. Id. at 442-443.

42. Ibid.

43. Ibid.

44. Id. at 447.

ISSUES AND REFORMS

It is 25 years since the banks have been nationalised in 1969, but the sentiment to celebrate this anniversary is absent as the balance sheet of majority of the public sector banks are in the red. In fact many of them are struggling to stay afloat as a result of which the government had to contribute funds.

In his budget speech for 1994-95, the finance minister has provided for Rs.5600 crores being the second instalment of government contribution to shore up the capital base of the nationalised banks.¹ If there is both incongruity and irony in the development, the reasons are not far to seek. In the past twenty five years in the wake of takeover of leading banks by the centre, social banking supplanted commercial banking and progress was only in terms of quantity and not quality. The major deficiency of the banking industry is its low profitability and the consequent inability of several banks to provide for adequate loan losses and to build capital. There are beside organisational inadequacies within banks, due inter-alia to their rapid expansion, weakening of management and control function, excessive staff, growth of restrictive practices and some erosion in work culture, flaws in credit management and the serious lag in introducing computer technology to handle the massive growth of banking transactions.

In other words the decline in profitability has emanated both from factors operating on the side of income and on the side of expenditure of banking industry. Factors both external to banks in terms of the macro policy environment as well as internal to them in terms of organisation, staffing and branch spread have been responsible for this.

Ironically a major strain on the financial performance of banks emanated from official policy. First, the automatic monetisation of the Central Government's budgetary deficit by the Reserve Bank of India creates excessive liquidity, to counter which banks are required to place cash deposits with the Reserve Bank at unremunerative rates of interest through high cash reserve requirements.

Secondly, the growing borrowing needs of the centre and the states have also been met by directing banks, through an increasing Statutory Liquidity Ratio (SLR) to invest in government and government guaranteed securities carrying below-market coupon rates. The coupon rates of interest on central government loans at 10.75%, 11%, 11.5% and 12.5% for loans with maturities of 5, 10, 15 and 20 years respectively are lower than the 13% rate paid on deposits.²

In 1991 at their peak the two reserve requirements together accounted for as much as 63.5% of incremental deposits of banks.³ Apart from such high handed investments, banks are also directed to provide 40% of their lendable resources at concessional rates of interest to the priority sectors namely agriculture, small and tiny industries, small business and weaker sections of the society. If this is also added to the SLR and CRR requirements, the banks would have been left with about 7% of total advances for profitable ventures.⁴ In course of time priority sector lending suffered from a measure of politicisation which damaged the quality of lending as well as the culture of repaying bank loans.

All these policies took place against the background of a heady expansion in the branch network of banks. Out of political compulsions, they were obliged

to lend more to risk prone areas, in the process suffering a grave erosion in the quality of assets. Socio-economic consideration prevailed over commercial judgment with the official stance being that credit to hitherto neglected areas must be provided at well below the cost of funds. This geographic spread of banking system led to a deterioration in service, internal control and in profitability. Commercial banks ceased to be commercial except in name, due to the regulatory framework under which they operated.

Despite misgiving on many aspects of Indian banking, one thing stands out. In the geographical reach and coverage of banking system since the nationalisation of banks in July 1969, the record has been outstanding. In all taking into account foreign banks, private sector banks and non-schedule banks the number of branches has risen from 8262 to more than 61000 with more than 50% of the new branches being set up in rural centers.⁵ The deposits of public sector banks alone have leap frogged from Rs.4000 crores in 1969 to more than 24200 crores as of Sept 1993 and advances from Rs. 3000 crores to more than Rs. 140000 crores.⁶ Of this, the relative share of priority sector has gone up from 14.9% in 1969 to 37.3% in 1993.⁷

The quantitative dimensions are impressive but unfortunately this very size has contributed to the present malaise of commercial banks. With the unprecedented branch expansion, banks are burdened with loss making branches. Even urban and metro branches are slowly sliding toward losses. Simply put banks found it difficult to operate keeping in view both Socio-economic criteria and commercial considerations. Virtually all of them opted for the former and in the absence of complete disclosure, resorted to window dressing of their accounts. As the Economic Survey for 1993-94 describes it "Quality of customer service has not kept pace and the time

taken for processing and completing bank transactions is too long. The failure to keep up with revolutionary changes in banking and communications technology has affected the spread and accuracy of service, internal controls and inter bank reconciliation of account. Both productivity and profitability has suffered as a consequence. As our exporters have found, reliable, efficient and low cost financial services are essential part of overall competitiveness".⁸

It has also not been easy for the banks to recover their dues through courts. Litigation is time consuming and frequently court decrees obtained after years of effort cannot be effectively executed due to erosion in the value of collateral and the restrictive laws about land use.

As already indicated credit management within banks had weakened due to deficient credit appraisals and supervision. This was also the result of an environment in which some bankers did not resist external pressures for loans to influential parties.

The fact that the public sector banks are wholly owned by the government created a sense of complacency. Adequacy for capital and even for that matter profitability were not emphasised. Besides, notions of confidentiality detracted from the transparency of bank balance sheets and profit and loss accounts. There was a tendency on the part of weak banks to make optimistic assumptions regarding accrual of interest income and to provide for loan losses in order to show better than actual profits. This led the Reserve Bank in 1985 to prescribe a code which required banks to classify their loan accounts according to the state of their health.⁹ Later it prohibited assumption of interest incomes by banks on four of the eight health code categories. Further where capital of

banks was found to be deficit due to their losses, the shareholders including the central government which wholly owns the nationalised banks began providing recapitalisation support. Also banks were required to draw up plans for upgradation of their operations and profitability and these were monitored by the Reserve Bank regularly.

Following the publication in 1986 of Capital Adequacy Norms by the Bank of International Settlement (BIS) for internationally active banks (8% of risk weighted assets) the question for adopting the same for Indian Banks became relevant as many of them have international operations and also because the risk factors facing domestic operations of all Indian Banks are no less serious than those confronting international banks.¹⁰ Similarly transparency of bank accounts and adoption of international standards regarding prudential norms, specially with regard to income recognition and asset classification became live issues. Capital support for weak nationalised banks has necessarily to come from the Central Government which had already made a provision for this purpose of Rs. 5700 crores in the 1993-94 budget.

Lending rate is another factor which is very amateurishly fixed. If the average deposit rate of savings bank and term deposit including fixed deposits is calculated it comes to around 8-9% at the threshold.¹¹ For any institution to lend this money at a profitable consideration the average rate of lending should vary between 14-16% per annum.¹² But the lending rates in the banks are abysmally low 4% to a maximum of 18% (the commercial lending rate).¹³ Since hardly 15% of the loan can be disbursed at commercial rates, the average lending rate stagnates around 11-12%.¹⁴ Thus with around 4% margin, the banks are expected to generate profits after meeting operational costs and adjusting bad and doubtful debts.

Another reason cited for low productivity of Indian Banks is that there are too many archaic rules and regulations. The banking sector in India has always been a highly regulated one for the purpose of the overall social benefit. In reality important decisions concerning banking policy and practice are taken by political heads who have little or no understanding of the intricacies of banking. Political gimmicks like loan melas and loan waiver have cost the banks dearly.

The nature of banking itself involves an element of risk taking, but in India this is largely absent since the rewards for doing so are negligible and the punishment heavy but arbitrary. Areas of responsibilities are lazily defined and due to weighty procedures which are frequently changed, there is rarely a proper fit between the person and the job.

There is no consistent policy on succession planning, delegation, recruitment, job rotation, motivation / penalty systems, performance appraisal, team building and other human resources management functions affecting organisational productivity. Banking has traditionally been regarded as a comfortable job with life long security. Unfortunately this aspect of a banking career seems to have become the primary motivator for most people at the officer and non-officer levels to join banks.

The rapid growth in numbers of staff and accelerated promotions have also diluted the quality of manpower. There has consequently been a perceptible decline in the quality of supervisory and managerial staff in banks. Overmanning at various levels

has become an unfortunate aspect of banks organisational system over a period. The trade unions have also contributed to the proliferation of restrictive practices in terms of work norms, resistance to mechanisation and computerisation and obstacles to rational in respect of promotions and staff transfers. Some of these practices have affected discipline and work culture and in the process also affected productivity and profitability.

The technology of bank operations has over the past few decades shown little improvement despite the manifold expansion of business which again has come in the way of providing efficient customer service in an industry which is essentially a service industry. A situation has arisen today where emoluments of bank staff and their revisions are no longer directly related to either productivity or profitability of either individual banks or of the system. The rate of growth of staff costs has been higher than that of the surplus of the banks. It is in this context that the Reserve Bank has advised banks to limit the expansion of their staff to around 1% against an average of 7% per annum between 1980 and 1985.¹⁵

Other than the banks lacking operational flexibility due to the directed investments and directed credit programmes it also lacks internal autonomy in their decision making process. This is not only in respect of credit sanctions but also in all aspects of internal management. There is excessive administrative and political interference in credit decision making which has seriously affected the autonomous functioning of banks. The matters have reached such a state that even in the case of postings and transfers there is interference. All this has contributed to a measure of de-motivation of the bank management and has affected their ability to take innovative decisions in the furtherance of the business.

Another important factor which erodes the profitability of banks are frauds committed on the banks. The total money lost in scam could have wiped off the total deficits of the union government.

The financial parameters for 1991-92 show the precarious position of commercial banks. Their gross profits after provisions and contingencies worked out to a meager 0.35% of their working funds, the spread between interest earned and interest paid was only 3.3% of working funds and domestic non performing assets accounted for 15% of their total advances.¹⁶ To top it all the capital base was much too narrow for comfort.

All this called for a drastic overhauling of the banking system. The immediate need was to go slow on branch expansion and expend energies on consolidation and revitalisation of this infrastructure so that it can play its role much more effectively than during the post nationalisation period.

It is in this context that the financial sector reforms suggested by the Narasimham Committee has to be studied and implemented so as to revitalise the public sector banks and make it stand on its own feet. The recommendations dealt with various aspects of the functioning of the financial system and the banking sector in particular. Since the report was made public, many recommendations have been implemented but still a definite pattern is missing. An integrated approach rather than adhoc measures are required which would auger well in eschewing doubts as regards the pace of financial sector reforms. The securities turmoil of 1992 also pointed out the urgency of remedial action to strengthen the banking system, restore its credibility and to regain the

public confidence.

It is nearly two and a half years since the Narasimham Committee submitted its report to the government in Nov 1991. Acting on these proposals the RBI has implemented some the recommendations while keeping a few on the waiting list. They are enumerated below:¹⁷

1. Accepting the suggestion of the committee for a phased reduction of the SLR to 30% on an incremental basis with effect from 3rd April '92. In the busy season credit policy announced by the RBI on 11 October '93 the SLR was reduced to 34.75% from 11 Oct '93 and incremental deposits after 17 Oct '93 from 30 to 25%. Likewise the CRR was also reduced to 14% from 17 April '92.
2. The new accounting norms were introduced in respect of income recognition and asset classification during the financial year 92-93.
3. Capital adequacy norms have been implemented in a phased manner. All nationalised banks were asked to attain a capital adequacy of 4% by March 93. Banks with overseas branches were supposed to reach 8% by March 94 while those whose operations are limited to the shores of the country were instructed to reach the figure by March 96.
4. The Recovery of Debts due to Banks and Financial institutions Act 1993 was passed in parliament providing for the establishment of tribunals for expeditious adjudication and recovery of debts due to banks and financial institutions.
5. A separate board for Financial Supervision of banks within the Reserve Bank of India would soon be established. Its function would be to ensure that the regulations and guidelines regarding capital adequacy, asset quality, provisioning, treasury operations etc. are complied with as per RBI policies.

6. The RBI allowed for the entry of new private sector banks by issuing specific guidelines on 22nd Jan 1993. On clearing of their proposals by RBI, UTI, ICICI and HDFC have already set up private sector domestic banks.
7. In October 1993, a memorandum of settlement between the unions and IBA finally enabled the banks to go ahead with computerisation.
8. The parliament has amended the Banking Act to enable nationalised banks to enhance their capital through public issues in the capital market. The SBI which could approach the market by virtue of SBI Act 1955 came out with a public issue recently.
9. The RBI liberalised the branch licensing policy while announcing the credit policy for the first half of 1992-93.
10. Lending rates have been rationalised and the number of slabs reduced. Some of the interest rates have been enhanced in order to minimise effect of cross subsidation. The rate of interest on Government Securities have been increased.

In the discussion paper entitled "Economic Reforms two years after and the task ahead" published by the Department of Economic Affairs, Ministry of Finance the following agenda has been set for the next three years:¹⁸

1. A complete ban on generalised loan waiver.
2. Institution of speedy and efficient loan recovery processes so that the public savings do not disappear but can be recycled to new products and borrowers who repay their loans.
3. A phased reduction in SLR to 25% and in the CRR to 10%, both these measures will increase the banks lending potential to the commercial sector.
4. Phasing out of ceilings and floors on bank deposit and lending rates respectively except

for the continuation of single concessional lending, set about 3% below the rate charged for prime borrowers.

5. Careful targeting of concessional lending to the really needy.
6. Ceiling on an environment in which banks will have better incentives to lend more to agriculture small industry and other priority sectors. This may also involve revamping of agricultural credit institutions.
7. Strengthening institutions and procedures for supervision.

Though these reforms which the Government has introduced after addressing itself to the weakness of the financial system, have no doubt created a conducive atmosphere for Indian banks to become highly competent and more efficient, yet the banks have not surged to seize the opportunity. Presently banks are flush with funds and the call money market is not able to absorb these surplus funds.

The fear psychosis among the top executives of banks that they have to maintain capital adequacy ratio, in case they increase the risk weighted assets through fresh loans have made them all the more relevant to make these additional lendings. Under these circumstances the benefits to the banking industry due to the reforms will be seen only after a few years.

The year 1992-93 was the year in which the reforms in the banking industry as suggested by the Narasimham Committee was set in motion by the Government. Hence it is important to study the effect, the recommendations had on the banking industry.

The accounts of public sector banks for 1992-93, reflect the application of the new norms and provide a realistic picture of their financial situation. As many as 13 out of the 27 public sector commercial banks incurred losses aggregating a whopping Rs. 3763.61 crores.¹⁹ The main reason for the banks suffering such huge losses is due to the implementation of the new income recognition, asset classification and provisioning norms. About 90% of the declared loss to the banks could be attributed to this factor. While the Syndicate Bank incurred a loss of Rs. 670 crores, United Bank of India, Central Bank of India and Bank of India sustained losses of Rs. 44 crores, Rs. 383 crores and Rs. 331 crores respectively.²⁰

Another factor responsible for the fall in profits is decrease in spread for many banks. The cost of funds has increased significantly during 1992-93. The rates of interest on deposits for 46 to 180 days have increased as a result of which there was shift in deposits from savings bank category to the term deposits category.²¹ The reduction in advance rates twice during the year in Oct 92 and March 93 by 2% in toto has its negative impact on the profitability.²² This has reduced the spread available to the banks.

The bankers expect the year 1993-94 to be worse than the 1992-93. The banks have provided only about 30% of the non-performing assets in the year 1992-93 and the remaining about 70% has to be provided in 1993-94.²³ Naturally losses are likely to amount up substantially. The position of different banks in respect of profits differ widely as some of the banks have operating losses, where as some others have net loss after provisioning. Accumulated losses will continue for some years to come. It will depend basically on the measures taken for revival and success there of as to how soon the

accumulated losses can be wiped off.

This is a gist of the problems and the remedial measures undertaken and the effect these reforms had on the banking industry. Individual issues of the banking industry and the remedial measures undertaken or required to be undertaken are discussed elaborately in the subsequent chapters.

NOTES :

1. S.Gangadharan, "Indian banking: quantity sans quality", Economics Times (Bombay), March 23, 1994.
2. Madan Sabnavis, "Success hinges on better recovery", Business Standard (Calcutta), June 19, 1992.
3. R.N. Malhotra, "Economic reform hinges on subsidies, taxes", Economic Times (Bombay), Feb 7, 1994.
4. Supra, n. 2.
5. Supra, n. 1.
6. Ibid.
7. Ibid.
8. Ibid.
9. A.C. Tiwari, "Our banks : Some neglected areas and problems - I", Financial Express (Bombay), Aug 5, 1992.
10. M.J.Subramanyam, "Two years of banking reforms", Financial Express (Bombay), Nov 1, 1993.
11. Ravi K. Wadhwan, "Tackling the banking sickness", Free Press Journal (Bombay), Nov 4, 1993.
12. Ibid.
13. Ibid.
14. Ibid.

15. Tamal Bandopadhaya, "Banks asked to find ways to trim surplus staff", Business Standard (Calcutta), Jan 16, 1994.
16. Supra, n. 1.
17. Supra, n. 10.
18. Ibid.
19. "Urgent need for reforms in banking sector", Lokmat Times (Aurangabad), Jan 30, 1994.
20. Ibid.
21. V.P.Taneja, "The stress during 1993-94 is on reducing existing NPAs and not to create any new NPAs", IBA Bulletin, P 138, Jan 1994.
22. Ibid.
23. Ramesh Mishra, "A multi-pronged approach has been adopted to improve profits and profitability of the Bank", IBA Bulletin, P 140, Jan 1994.

PRE-EMPTION OF FUNDS

All scheduled commercial banks classified under section 42 of Reserve Bank of India Act, 1934 have to maintain certain reserves with the Reserve Bank of India. These are called Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR). These reserves are part and parcel of the credit control measures and are subject to changes as per the directions of the Reserve Bank of India which is the sole authority for framing the monetary policy of the country.

Under section 42 of the RBI Act, every scheduled bank is required to maintain with the RBI every fortnight a minimum average daily cash reserve equivalent to 3% of its demand and time liabilities in India outstanding as on Friday of the previous fortnight. By an amendment to the Act since March 29, 1985, the basis for maintenance of average daily cash balance at the close of each day stands changed from 'weekly' to fortnightly. The RBI also has the power to vary the CRR between 3% and 15% by an amendment of the Act in 1962.

Apart from the normal CRR, the RBI is vested with the power to prescribe additional cash reserve requirement on incremental deposits accruing from a base date as may be notified by the RBI. The additional CRR, however, is subject to the proviso that it is not to exceed 100% of the total DTL over the prescribed base level and further it should not result in increasing the effective CRR beyond the statutory minimum of 15%. The effectiveness of the CRR requirement has been augmented by imposing the additional cash reserve requirement over and above the CRR specified from time to time.

Thus, the total cash reserves that are actually maintained by a scheduled

commercial bank consists of ¹ -

1. The minimum statutory cash reserve of 3%.
2. Additional reserve to meet the difference between the CRR and the statutory cash reserve of 3%.
3. The additional cash reserve relating to incremental DTL as may be prescribed from time to time; and
4. Excess over and above the level required to comply with the prescribed cash reserve requirement of shortfall therein.

The liabilities of a bank for the purpose of compilation of CRR include net inter-bank liabilities (excess of inter- bank liabilities over inter-bank assets) but exclude paid -up capital and reserves. As per section 18 and 84 of Banking Regulation Act 1949, liabilities in India shall also not include a credit balance in the profit and loss account and any advance taken from RBI or Industrial Development Bank or Exim Bank or NABARD.

RBI has been empowered under section 18(2) of the Banking Regulation Act 1949 to specify from time to time the nature of liabilities in India to be included for computing Demand and Time liabilities for CRR purposes and in case of any doubt RBI's decision is final. If this requirement is not complied with RBI can impose penalty on the defaulting bank under section 42(3) of the RBI Act. For every shortfall in a week, a penalty of 30% over the bank rate is payable for that week. If the shortage continues beyond a week, penal interest at 5% over the bank rate is imposed. Reserve Bank also imposes fine on the officers responsible for default. Further, the defaulting bank

is denied access to refinance / rediscount facilities since March 30, 1979.

CRR is a means to regulate the money supply available with scheduled banks and ultimately effects the money with the public. Since June 1973 CRR has been changed a number of times starting from 5% to the present 14% in 1994². At its peak in 1991 the CRR stood at 15% and a 10% incremental ratio³.

According section 24 of the Banking Regulations Act 1949, every bank (scheduled or non scheduled) is required to maintain, at the close of business everyday, a minimum proportion of their time and demand liabilities in India as liquid assets in the form of cash, gold and unencumbered approved securities. For this purpose unencumbered securities will include approved securities lodged by a bank with another institution for an advance or any other credit arrangement to the extent of undrawn balances against such lodged securities included for computation of SLR.

The ratio of liquid assets to DTL is known as SLR. Originally the maximum SLR that could be fixed by RBI was 25% but by a notification issued under the banking laws Amendment Act, 1983 the RBI has been empowered to increase SLR upto 40%. The DTL, to which the liquid assets of the banks are related for computing the SLR, include all liabilities except paid-up capital and reserves, borrowings from RBI, IDBI and NABARD. The CRR maintained by a bank is not included for computation of SLR.

The SLR has been changed several times by the Reserve Bank of India (RBI). The SLR in 1991 at its peak stood at 38.5%⁴.

The increase in CRR and SLR ratios is instrumental in checking inflation whereas a decrease in the ratios results in pumping in more funds in the economy. By these instruments the RBI effects a proper control on the credit allowed by the banking institutions on the important sectors of the Indian economy.

The overall effect of any change in CRR and SLR will result in impounding several hundred crores of rupees of the banking funds. By this measure speculative tendency in any industry is checked by banks by refusing to advance further money under directions of RBI. Hoarding of any commodity for speculation purposes can thus be quickly checked. However by impounding a big percentage of bank deposits, the banking institutions are deprived of their lending capacity and profitability of banks is also effected as a very small percentage of deposits are left with banks for advancing at commercial rates.

The high level of SLR requirements have also tended to crowd out the non-government sector's access to bank funds, thus depriving more productive activities of resources from the banking system. By itself a high level of SLR requirements need not have affected profitability of banks if interest earnings on investments were remunerative. But since the rates paid on Government obligations was less than market related rates, the imposition of high level of SLR requirements was in effect acting as a tax on the banking system.

Cash Reserve Ratio is an important instrument for monetary control, but in terms of the income effect on banks, the impact of high cash reserve

requirement once again is related to the interest that is paid on deposits above the basic minimum of 3%.

At present a whole lot of liabilities are included in the calculation of Net Demand and Time liabilities (NDTL) and there are quite a few again which are not. The deposits of a bank will account for around 90 to 95% of the NDTL with some other liabilities (like bills discounted) making up the rest⁵. Certain categories of deposits, mainly the various foreign currency deposits are not included. So the deposit level is the closest indicator of the NDTL of a bank on which it has to maintain CRR at the prescribed rate.

The deposits of the scheduled commercial banks have increased by Rs. 25,583 crores (end-March 1991), Rs. 38,216 crores (end-March 1992) and Rs.37814 crores (end- March 1993) in the last three years ending March 1993⁶. The CRR for the period has varied between 15, 14.5 and 14% at present⁷.

The first 3% does not earn any interest and must therefore be excluded from the calculation. Thus the effective CRR is 11% of the deposits. At 11% the CRR works out to be Rs.2814 crores, Rs.4203 crores and Rs.4159 crores respectively for the increase in deposits in the last three years⁸.

As the RBI has not paid any interest from October 92 onwards, the first two figures have not earned interest for a period of 18 months between October 1992 and March 1994. The deposit increase of Rs. 37,814 crores as of end- March 1993 has to be divided into equal halves as interest was paid on CRR on the deposit growth till October 1992.

The CRR on Rs.18,907 crores earned interest till October 1992. After this date not only did CRR on Rs.18,907 crores not earn interest, the remaining increase in CRR on the deposit growth of the remaining half of Rs.18,907 crores also did not earn any interest. In effect, Rs.18,907 crores earned interest at 10.5% for six months and any amount larger than this did not earn any interest for six months. If the interest loss on CRR is calculated for Rs.18,907 crores for six months then it amounts to Rs.109.18 crores (on CRR of Rs. 2079.77 crores maintained on a deposit growth of Rs.18,907 crores till October 1992) for the six months ended March 1993. For the next year, the loss is Rs.436.75 crores (on CRR of Rs. 4159.54 crores) taking the total to Rs. 545.93 crores for the 18 months period⁹.

The CRR on deposit growth for the years 1990-91 and 1991-92 has also not earned any interest for 18 months ending March 1994. The interest income loss for these two years is Rs.443.22 crores and Rs.662.08¹⁰. The interest income lost on the 10% incremental CRR is Rs.404.46 for the same period¹¹.

The total loss of interest income to banks on CRR for the 18 months period ending March 1994 works out to Rs.2055.69 crores¹². Thus, a significant portion of the loss of the banks which will be evident in March 1994 can be said to be a direct result of the RBI'S decision not to pay any interest on CRR.

Even if we take the position at the end March 1993 into account, the total loss shown by the banks is Rs.3369 crores and the interest loss on CRR is Rs.612.44 crores¹³. This means that around 20% of the banks losses can be attributed to the RBI'S

non-payment of interest on CRR. Significantly, this does not include the compounded impact of the accrual of interest income over the 18 months period. As interest is paid on the fortnightly average CRR deposits maintained by banks, the interest earned by banks would have been deployed further to earn more money for the banks.

Of course, it is not possible to attempt quantification of this further loss to banks for lack of fortnightly figures of CRR. Yet senior bankers maintain that the impact would have been significant for individual banks even if 40% of this interest income had been lent to the priority sector, according to the RBI guidelines, and the remaining 60% deployed commercially¹⁴.

The net result of this non-payment of interest is significant should we take individual cases into account. The CRR amounts on which banks are not getting any interest are quite significant. (as per table).

While it is not possible to calculate the exact loss suffered by individual banks as fortnightly figures for CRR are not available, an approximate picture can be had by calculating the interest loss at 10.5% for one year on the CRR not earning any interest at present and comparing it to the profit or loss of the bank.

This annual interest loss calculation is based on current figures of CRR not earning interest, which were dangerously less some time ago. But this will sort of compensate for the compounding effect and will give a rough picture. Also, this figure of CRR not earning interest will only go up further till March, 1994.

TABLE 1

Interest loss of individual banks
(All figures in Rs. crores)

Bank Name	CRR Not Earning Any Interest			Loss of interest at 10.5% p.a.	Profit/ Loss	1994 CRR interest foregone as % of Mar 93 balance sheet loss
Bank of India	1000	150	1150	120.75	-331.12	36.47%
Bank of Baroda	1290	180	1470	154.35	8.23	N.A.
Union Bank of India	430	67	497	52.18	11.26	N.A.
Dena Bank	341	27	368	38.64	-90.46	42.70%
Bank of Maharashtra	190	13	203	21.31	-196.51	10.84%
Syndicate Bank	308	22	330	34.55	-670.08	5.16%

Source: Financial Express (Bombay), 14 February 1994.

Thus we have figures ranging from Rs.154 crores (Bank of Baroda) to Rs.21 crores (Dena Bank) for individual banks ¹⁵. What is significant here is not the mere fact that banks are losing money in interest. It is the fact that this loss increases with every increase in either the deposits or the Net Demand and time liabilities of a bank.

The RBI's argument is that the payment of interest detracts from the role of the CRR as an instrument of monetary control. But that requires detailed consideration by itself.

It is in this regard that the recommendations of the Narasimham Committee are important in terms of SLR and CRR requirements to ensure that the ailing banking system is given new life. The committee's views and recommendations are enumerated below ¹⁶.

As regards the directed investments in terms of SLR and CRR, the committee is of the view that SLR requirements need to be related, as they were originally intended to be, to prudential requirements and not as a monetary instrument or as they have since become, a major instrument of mobilisation of the household sector's financial savings in the form of its deposits with the banking system to finance the public sector. In a situation of large revenue deficit, credit to the Government at the margin, is going to finance consumption rather than be available for financing investment and productive activity. The reduction in fiscal deficit of the Government should provide the background for a gradual winding down of SLR from its present levels which could be regarded as being unsustainable in terms of limiting operational

flexibility of banks, in depressing their potential earning and in 'crowding' out the legitimate needs of the commercial sector for bank credit. With the Government's reduction of fiscal deficit, it should be possible for the SLR to be reverted to 25% of the net demand and time liabilities in the next 5 years in a phased manner. A reduction in SLR levels should enable banks to allocate their resources on a flexible and efficient basis to promote investment in agriculture, industry and trade with due regard to the productive use of their resources. Also the Government borrowing rates should be market related and this should help the banks augment their income from their SLR investments.

As regards the CRR, the Reserve Bank should be given the requisite freedom to operate this instrument in terms of its monetary policy goals. The committee proposed that the Reserve Bank consider a progressive reduction in CRR from its present high level. It is also viewed that if the instrument of CRR were deployed, the Reserve Bank should pay interest on impounded deposits above the basic minimum, at a rate which would be broadly related to the bankers average cost of deposits.

Accepting the recommendations of the Narasimham Committee, the RBI brought down the SLR to 30% on an incremental basis with effect from 3 April 1992¹⁷. On 11 OCT 1993 during the busy season credit policy, the SLR was further slashed to 34.75% and incremental deposits from 30 to 25%¹⁸.

Likewise the CRR was also reduced to 14% in two phases of 0.5% each beginning from 17 Apr 1992¹⁹. These measures provided the banks with an additional fund of Rs.4150 crores during the second half of 1993-94 for effective deployment²⁰.

But the banking industry has not responded to these reforms. The Narasimham Committee recommended the reduction of SLR and CRR with a view that the funds so freed will be used to promote investment and production in agriculture, industry and trade.

However banks seem to be hesitating in stepping up their lending activities especially to the industrial sector because of uncertain credit environment, drastic erosion of profitability due to new provisioning norms and severe strain on the capital base as a result of the new norms on capital adequacy.

Importantly, capital adequacy norms are forcing the banks to avoid industrial lending. These norms require that for every hundred rupees advanced for industrial borrowers, the banks will have to increase their paid - up capital or reserves or their tier II capital in the form of deep discount bonds, revaluation reserves etc. by an amount of eight rupees. This amount has to be raised from the capital market because Government may not continue to give a helping hand in the form of infusing capital.

Because of these, the industrial lending has not improved and banks are deploying their funds in risk free investment such as Government treasury bills, as the coupon rates have also been increased for them.

The trade and industry's complaint is that the effects of the banking reforms have not percolated to them and they want the bankers to respond positively to the

reforms. Taking note of this complaint Dr. Rangarajan, Governor, RBI, has exhorted the banks to ensure that credit flow improves to the trade and industry.

The banks will have to take reasonable risk and extend their helping hand to deserving borrowers as industrial lending is essential for creation of capital assets and generation of employment opportunities.

NOTES:

1. H. R. Suneja, " Practice and Law of Banking ", (1991), P 127-128.
2. R.N. Malhotra, " Economic reform hinges on subsidies, taxes", Economic Times (Bombay), Feb 7, 1994.
3. M.J. Subramanyan , " Two years of banking reforms", Financial Express (Bombay), Nov 1, 1993.
4. Supra. n.2.
5. "CRR interest: Banks lose Rs 2000 crores to RBI", Financial Express (Bombay), Feb 14, 1994.
6. Ibid.
7. Ibid.
8. Ibid.
9. Ibid.
10. Ibid.
11. Ibid.
12. Ibid.
13. Ibid.
14. Ibid.
15. Ibid.
16. Report of The Commission On The Financial System, (M. Narasimhan, Chairman), Nov 1991, P 39-41.

17. *Supra*, n.3.

18. *Ibid.*

19. *Ibid.*

20. *Ibid.*

PRIORITY SECTOR

The priority sector concept took shape in 1967 when Prof. Gadgil study group urged the commercial banks to lend to sectors such as agriculture, small scale industries and small business as these sectors were not getting the required financial support¹. Nationalisation of banks added impetus to the priority sector lending by banks, priority in terms of allocation of credit and concessions in terms and conditions. Until 1969 banks in India catered mainly to the credit needs of large industrial houses and trading concerns. In fact many of the banks presently nationalised were established by influential business houses to facilitate easy credit for themselves and their associates.

In 1970, the RBI identified certain neglected sectors, where bank credit required to be channelised². In 1972 some additional sectors were also given priority status³. Banks were instructed to afford priority credit for these sectors and so they came to be called as priority sectors. So priority sector advances means an advance to any of the following sectors⁴:-

1. Agriculture and allied activities like poultry , dairy etc.
2. Transport operators.
3. Retail traders.
4. Small businesses.
5. Professional and self employed.
6. DRI (Differential rate of Interest) loans.
7. Residual category coming under (6).
8. Educational loans.
9. Small scale industries.

Education loans were included in the priority sector only of late. The priority sector advances enjoy a concessional rate of interest. Sub limits are fixed for each of the sector to come under the definition of priority sector. For example a transport operator possessing upto six vehicles comes under priority sector. If the operator possesses more than six vehicles then he ceases to come under priority sector category⁵. Similarly limits are fixed for other categories also.

The Ghosh committee in 1981 identified the weaker sections and prescribed benchmarks to be achieved by the banks in terms of credit deployment to priority sector and various sub-sectors within priority sector⁶. The RBI has been from time to time revising its guidelines to banks on priority sector lending which on date stands as⁷:-

1. 40% of the total credit should go to priority sectors.
2. 25% of the priority sector advances should go to weaker section beneficiaries.
3. 18% of total credit should go to direct agriculture.

Foreign banks are required to reach 32% only and export credit for them is also included in the list of priority sectors⁸.

The concept of social banking which originated in the early seventies spread like bush fire with everybody, the politicians, the bankers, the socialists etc. contributing to it, thus providing succour and warmth to thousands of beneficiaries belonging to small scale industries, landless labourers, farmers etc. But soon the good aspects in the concept were overshadowed by the bad aspects.

While the banking sector was serious in implementing the benchmarks for achievement under priority sector, certain pressures were built up affecting the operational efficiency and profitability of the Indian banking system. Political interference began in this concept when another overlapping concept of the Integrated Rural Development Programme was started and the resultant nexus between state government and the bank managers began to be facilitated. Very soon this political level interference took monumental proportions when the Minister of State for Finance Mr. Janardhan Poojary openly incited the priority sector customers to indulge in militancy against the branch managers who refused to sanction loans to them⁹. Very soon the bulk of the priority sector loans became non performing assets for the banks burdening them beyond their tolerant limits.

Since the priority sector advance was considered to be an accelerated credit, with the growing number of accounts, the quality of appraisal, inspection and follow up of credit suffered. In order to take care of agricultural overdues under the ARDR scheme of 1991, the Government of India had to compensate as much as Rs 15,000 crores towards agricultural and the other small advances of less than Rs 10000¹⁰. In regard to the revenue generating aspect of such lending, the banks had to be satisfied with inadequate rate of return, which was ranging between 4 and 15%¹¹. Since Indian banks were already handicapped due to low profits, high staff expenses and high cost of operations, the continued deployment of subsidised credit to such priority areas resulted in decrease of revenue.

It was at this juncture that the recommendations of the Narasimham

committee was released. The committee was of the view that the directed credit programmes have played a useful role in extending the reach of the banking system to cover sectors which were hitherto neglected¹². However, the committee felt that the pursuit of distributive justice should use the instrumentality of the fiscal rather than the credit system¹³. Therefore, the committee was of the view that directed credit programmes should not be a regular feature, but rather be a case of extraordinary support to certain sectors in the absence of economic compulsions to make credit available to them and designed to correct perceived imperfections in the credit market¹⁴. The Committee believed that the issue was how to consolidate the qualitative gains that have been made while improving the quality of the loan portfolio and health of the banking system. Macro credit guidance should continue to be a legitimate aspect of developmental credit policy but micro credit intervention, sometimes bordering on behest should be eschewed¹⁵.

The committee felt that directed credit programmes have led to segmentation of credit markets and introduced an element of inflexibility in bank operations¹⁶. Further, the stipulation of high proportion of allocation coming on top of informal direction in favour of food procurement and allied activities after pre-empted use of bank resources through the SLR/CRR mechanism has meant that the traditional sectors of medium and large industry and trade have often been subject to severe restriction with consequent deleterious effects on the growth of industrial investment and production¹⁷.

The committee feels that the growth of agriculture and small industry has now reached a point where the legitimate product requirements of these sectors (or

large parts of them) could be met by banks on the basis of their commercial judgement¹⁸. After considering the two decades of such preferred credit the committee evaluated the continuing need of it and came to the conclusion that the priority sector credit should be made available only to the really needy such as small and marginal farmers in agriculture and the tiny sector in industry¹⁹. Those who can stand on their own feet like the large and medium farmer and most of the small scale industry are to be granted credit by the banks based on their commercial judgement.

The committee, therefore, suggested that the system of directed credit programme should be gradually phased out²⁰. Taking into consideration that some sectors may continue to need credit support the committee proposed that directed credit programmes should cover a redefined priority sector, consisting of the small and marginal farmers, tiny sector of industry, small business and transport operators, village and cottage industries, rural artisans and other weaker sections²¹. The committee also proposed that the credit target of this redefined priority sector be fixed at 10% of aggregate bank credit which it feels is the credit flow to the above cited sectors at present²². The Committee also proposed that a review should be undertaken at the end of 3 years to see if directed credit programmes are to be continued. It also feels that the stipulation of concessional interest to the redefined priority sector should be reviewed with a view to its eventual elimination in about 3 years²³.

With regard to large and medium farmers and small industries the committee recommended non-invasive means of credit direction such as a return to the system of preferential refinance from the RBI in respect of incremental credit without any loosening of eligibility criteria for such refinance²⁴. This would make it profitable

and attractive for the banks to enlarge their credit to these sectors but would leave the primary decision making to the banks themselves on the basis of the income generating aspects both in respect of the enterprises being financed and the banks themselves. It would revert to the original postulate of social banking, viz, that credit should be an instrument of enhancing productivity over large areas of agriculture and small industry. In this sense the committee believed that there would be no conflict between the postulates of sound banking on the one hand and social banking on the other²⁵.

The bankers anticipating that the Narasimham Committee recommendations submitted in Dec 1991 would be accepted by the RBI had begun curbing lending to the priority sectors. So the banking sector for the first time in 1991-92 fell short of the priority sector target by one percent²⁶. In 1992-93, they fell short of the target by 3%²⁷. The total priority sector outstanding advances as of March 1993 was Rs 46652.77 crores amounting to 36.64 percent of the total bank credit as compared to the outstanding advances of Rs.44581 crores during the corresponding period of the previous year²⁸. The total number of accounts for 1993 amounted to 3.61 crore against 3.56 crore achieved at the end of 1992²⁹. The shortfall in the priority sector target is despite the increase in quantum loan by Rs.2071 crore to the priority sector and an addition of 5.46 lakh new accounts during 1993 signifying stepped up efforts by banks³⁰.

Banks have also failed to achieve the stipulated target of 18 percent agricultural credit for March ending 1993³¹. The percentage quantum of total agricultural credit was around 14 percent as compared to 15.3 percent achieved in 1992³². Total agricultural credit in 1993, including direct and indirect credit was estimated to be around Rs.20,020 crore amounting to only 14 percent of the total credit as against Rs.18,265 crore

credit extended to the agricultural sector in the previous year³³. The shortfall in 1993 is despite increase of around Rs.2000 crore credit to the agricultural Sector³⁴. Similarly direct agricultural credit increased from Rs.16,926 crore attained in March 1992 to the level of Rs.18559 crore achieved by March 1993 showing a net increase of over Rs 1600 crore³⁵. Also the total number of accounts under direct agriculture has also shown a marked increase of about 4.64 lakhs³⁶. According to the bankers the shortfall in the priority sector lending and especially agricultural credit was mainly on account of the continued uncertainty on the lowering of target as suggested by Narasimham committee. It was only in November 1992 that the Finance Minister Dr. Man Mohan Singh categorically ruled out the lowering of priority sector target. By then the main season had already passed off.

The recommendations of the Narasimham committee with regard to priority sector sparked off serious debates for and against and this was one of the main reason for the uncertainty of the government's decision. The critics feel that whenever there is a debate on the question of dwindling profits of commercial banks, it invariably ends up with identifying the advances to weaker sections and priority sectors as the primary cause of falling profits. The argument against the Narasimham committee recommendation is that the committee instead of taking the socio-economic cultural context of the country into consideration against the background of the concept of welfare state enshrined in the directive principles of the Constitution, took a traditional mechanistic view of banking³⁷. "The committee puts forth its arguments like a committee of bureaucrats rather than a committee of social scientists"³⁸.

D . N Ghosh argues "when a very large segment of people in the

vulnerable sections have to be brought within the network through the instrumentality in the initial stages in non market interventions even the worst critics of banking system cannot deny the success of such non-market interventions in many sectors in many places all over the country and the need for it in the interest of greater employment, productivity and social justice continues to exist"³⁹.

The critics argue that the banking sector cannot function on pure commercial considerations, since commercial considerations basically help only the strong and the powerful upper strata of the society⁴⁰. They feel that in the long run, it will ultimately lead to inequitable distribution of income in favour of the wealthy class and encourage unproductive and speculative business activities. The rural urban conundrum will persist, the rich-poor gap will increase and the distribution of income will be lopsided, resulting in the destabilising of the economy like a reverted pyramid with a very weak base⁴¹. Arguing against the argument that priority sector advances is less profitable Ghosh says, "If delinquency in the directed credit programme is what is worrying the Narasimham committee and has prompted it to suggest consolidation, then equally the large level of delinquent loans which have infested the traditional sector should have prompted it to suggest curtailment of lending to these sectors"⁴².

The Government, because of political and social considerations did not implement the Narasimham committee recommendations for the priority sector. Instead the finance ministry warned the banks of penalty in case they do not meet the target of 40%. The State Bank of Travancore fell short of the target by 11% in 1992-93⁴³. The parent bank, State Bank of India achieved only 29.71%⁴⁴. Syndicate Bank with 30% and Bank of India with 33% followed⁴⁵. The Reserve Bank of India

finds the present structure inadequate, as the penalties are ineffective under the current circumstances.

In anticipation that some banks may still not achieve the target in 1993-94, the RBI had, in November 1993, threatened the industry with "bank specific action" including raising of reserve requirements and withdrawal of refinance facilities in the event of a shortfall⁴⁶.

However these threats are not realistic as penal measures. Banks in any case are not availing of the refinance facility due to the easy money market conditions. With call money rates hovering at around 5%, they have no incentive to take recourse to refinance. Again raising the statutory liquidity ratio (SLR) of banks is unlikely to upset public sector banks very much, as most of them hold approved securities in excess of their requirements. This situation has come about as the government is now paying market rates on these securities as against the low controlled rates earlier. With good assets being scarce, banks have lapped up government paper in a major way. An added incentive for the banks is that the government paper does not attract capital adequacy requirements. This leaves only the raising of the cash reserve ratio on the RBI's indicative list of penal measures. There still remains the possibility of the RBI asking public sector banks to deposit the amount of shortfall in the target with Small Industries Development Bank of India at a penal rate of interest. This has been applied to foreign banks. It is however felt that this would send a wrong message to the public sector banks. Most of them would prefer the SIDBI deposit route to direct priority sector lending which leads to problems of recovery and high administrative costs. If banks opt for SIDBI deposits, RBI officials feel it defeats the very purpose for which the priority

sector lending norms were introduced. With only the weapon of moral persuasion remaining, the RBI is rethinking its strategy.

While it is important that priority sector advances should continue and targets set should be met, it is also important to analyse certain categories of priority sectors to determine whether a redefinition is required⁴⁷.

1. Agriculture; All direct advances to farmers in the form of short term, medium and long term loans are included under this head. Indirect finance includes retail trade in fertilisers, loans to state electricity boards for energising wells etc. The Narasimham committee had made a suggestion to exclude agriculturists with large land holdings from the purview and to confine only farmers with land holdings of less than five acres. Agricultural income is not taxable and many State Governments have implemented margin money schemes for certain sectors.

To include large agriculturists with extensive land holdings under this category and extend them concessions which they do not merit, deprives the small and marginal farmers of these benefits which would have gone to them. No doubt agriculture deserves a priority as it shapes the Indian economy to a great extent, but the incentives should go to the sector that deserves them. Large farmers should continue to be assisted by banks but at the commercial rates of interest applicable to general advances.

2. Small Scale Industries: SSI units are those engaged in processing, manufacturing or preservation activities having a total outlay of less than Rs 60 lakhs in plant and machinery. But to be brought under the priority sector the outlay should be less than Rs 35 lakhs. SSI units enjoy several concessions from the central as well as State Governments. Moreover, now the SIDBI has become fully operational and it caters exclusively to the

SSI sector. Two decades ago when the SSI sector was in its fledgling state, banks were instructed to assist them by way of easy credit facilities, but today the situation has changed drastically. A rethinking is needed as banks cannot continue to extend facilities at interest rates of around 15%, when their cost of funds are about the same. If the investment limit is reduced from Rs35 lakhs to Rs 10 lakhs, it would ensure that only the smallest entrepreneur is assisted at concessional rates.

3. Retail Trade: Banks can extend a finance of only upto Rs 25000 to a retail trader to be brought under priority sector. The amount is too meagre as the average working capital requirements of a retail store in an urban or semiurban area would be far above the sum. If assistance to this sector by way of credit facilities is to be meaningful, this limit has to be raised to at least Rs one lakh.

4. Professional and self Employed Persons: Under this, doctors, engineers, chartered accountants, lawyers are included besides others like carpenters and masons. A doctor having a good practice or a lawyer having a good client, when extended a credit facility from a bank for buying equipments books etc. enjoy priority sector status and consequently lower rate of interest and repayment terms. To equate this high class borrowers earning substantial incomes with a carpenter or a mason who has to necessarily use his skills learned for earning his livelihood is improper. The doctors, lawyers and other such professionals can afford to pay a higher interest rate and the banks should not be deprived of this revenue. A redefinition under this head to exclude professionals who are earning an annual income of Rs 50000 or above has to be taken, to ensure that precious bank credit reaches the persons in the lower strata.

5. Road Transport Operators: Advances granted to operators engaged in transport of

goods or passengers come under this category. It follows that truck/bus operators who avail of finance from banks come under this category. A bus or a truck costs anything between 7-9 lakhs today, out of which the borrower is required to bring in at least 25% (i.e. about Rs 2 lakhs) as his contribution to the cost of the vehicle. A person who is able to bring in this huge amount cannot be classified a small borrower and there is no requirement of extending priority status to him thus making him eligible for concessional credit. A redefinition in this sector should exclude all transport operators who require a credit assistance of Rs 3 lakhs or above.

The above changes mooted in the area of priority sectors is long overdue. The changes if implemented would reorient the concept of priority sectors towards what it stood for when it was envisaged in 1970 that the under privileged sections of the society should be given a chance to come up to the average economic standards by placing them in a distinct category vis-a-vis bank credit. A lot has changed since 1970 and hence a redefinition and redirection is necessary to direct scarce credit to sectors that need them. Consequently with many existing sectors going out of the priority sector bracket bank credit to this sector would come down from the present 40% to less than 20%⁴⁸. Thus it would be easier to implement the Narasimham committee recommendation of restricting priority sector lending to 10%. Banks would definitely welcome this implementation as they would be able to earn an average of around 17-18% on their loans⁴⁹.

With increasing autonomy being given to banks in several crucial areas of development, the RBI should free the banks of the directed credit mandate in a phased manner, to permit them further maneuverability in their operations. Only

this would carry the liberalisation policies initiated so ambitiously in the area of banking to its logical conclusion.

NOTES

1. Rajagopal, "The priority sector ", IBA Bulletin, P 52, Jan 1994.
2. K.Shankar, " Priority sector lending - redefination needed", Financial Express (Bombay), Feb 16, 1994.
3. Ibid.
4. R.Meenakshi, "Need to redefine priority sector", Financial Express (Bombay), Sep 16, 1993.
5. Ibid.
6. Supra, n. 1.
7. Supra, n. 2.
8. Ibid.
9. S. Saroja, " Need for new approach in priority sector lending", Financial Express (Bombay), Jan 19, 1994.
10. Supra, n. 1.
11. Ibid.
12. Report of The Committee On The Financial System, (M. Narsimham, Chairman), Nov 1991, P 41.
13. Ibid.
14. Ibid.
15. Ibid.
16. Ibid.
17. Ibid.
18. Id. at P 43-44.
19. Ibid.

20. Ibid.
21. Ibid.
22. Ibid.
23. Ibid.
24. Id. at P 45.
25. Ibid.
26. "Shortfall in priority sector lending", Financial Express (Bombay), Aug 21, 1993.
27. Ibid.
28. Ibid.
29. Ibid.
30. Ibid.
31. Ibid.
32. Ibid.
33. Ibid.
34. Ibid.
35. Ibid.
36. Ibid.
37. Dr.N. Murari Ballal, "Tragic transition from mass banking to class banking", The Independent (Bombay), Sep 20, 1992.
38. Ibid.
39. Ibid.
40. Ibid.
41. Ibid.
42. Ibid.
43. Mahesh Jayaraman , "RBI to revamp penalties for priority lending shortfall", The Economic Times (Bombay), April 9, 1994.

44. Ibid.

45. Ibid.

46. Ibid.

47. Supra, n. 2.

48. Ibid.

49. Ibid.

PROBLEMS OF BANK RECOVERIES

It is a common knowledge that banks have been experiencing considerable difficulties in the matter of recovery of loan. The quality of the Indian banks loan portfolios has deteriorated and a culture of non-recovery has surfaced in many parts of the banking system, says the London based journal, "The Banker"¹. Lack of expeditious court remedies has been one of the major impediments experienced by the banks and financial institutions. The experience is that not all loans are bad because of genuine Industrial sickness. A large number of them owe their existence to willful defaulters. Such borrowers withhold repayments because they find that committing defaults in payment of existing loans is financially more advantageous than repaying such loans and raising new resources at higher cost for their current operations. They are aware that even if the bank decides resort to legal remedies, they would not be touched for at least 10 to 12 years, thanks to a maze of procedures, overburdened judges and most of all the ingenuity of their lawyers in adopting dilatory tactics.

As a result, a large proportion of bank funds have remained locked up for years at the most unremunerative returns. In addition to this, banks have to incur a substantial amount of expenditure by way of legal charges which adds to the mounting overheads of banks. Not only that, the abnormal delays in obtaining court decrees results in erosion of the mortgaged assets, poor realisations and write off of substantial part of the loans. In many cases, the banks have not been able to recover even the expenses incurred on legal fees and protection of the assets. The recovery of loan is important from the point of view of recycling of funds, safe guarding the trust and

confidence of depositors and also drawing refinance from NABARD.²

Improvement in the recovery rate is insisted on many grounds.³

1. Recycling as an object of banking assures development of different sectors and individuals. Dwindling recovery applies brakes to recycling of bank funds. In a developing country, development programmes long for institutional credit. This is possible only through the fast recycling of institutional funds as the capital is scarce in India.

2. Banks find difficulties in the recovery of principal and accrued interest in the cases of willful default. As the willful default is contagious in nature, banks profitability gets affected to that extent.

3. Declining rate of recovery enlarges the volume of doubtful debts which in turn warrants more provisions. Prevailing provisioning norms are more stringent and adversely affect the profitability of banks.

4. Drop in the rate of recovery has direct relationship with banks productivity. A bank with low productivity does not provide for reserves and its financial soundness is at stake. Ultimately this may hamper the development of bank's business.

5. Financial business has no other risks except bad debts. Ineffective recovery mechanism is the prime cause for the accumulated bad debts. Ineffective recovery forms base for doubting the caliber of management and justifies lack of involvement on the part of personnel.

On account of these reasons, the Tiwari Committee as well as Narasimham Committee had advocated the establishment of special tribunals to expedite the disposal of bank cases. Even the banks and the financial institutions have for a long time, been urging for setting up of tribunals to deal with their cases expeditiously, which remained an illusion for more than a decade.

It is heartening that the cry of the bankers has been ultimately heard by the government which recently came out with an Act for the purpose, namely, the Recovery of Debts due to Banks and financial institutions Act 1993. It is learnt that to begin with these tribunals will be established in the four cities of Bombay, Calcutta, Delhi and Madras and then spread to other places in due course⁴. But the public sector banks, burdened by a growing portfolios of non-performing assets have asked for the establishment of debt recovery tribunals at all state capitals, in addition to the ones proposed to be set up at the 4 metropolitan cities.

A beginning in this direction has been made with the decision to set up a tribunal at Bangalore with jurisdiction over cases in Andhra Pradesh and Karnataka according to Banking circles⁵. The establishment of the tribunals has been dogged by delays and bankers blame the government for not having made the appointments of judges for these tribunals as yet. The tribunals are to be headed by a person who shall be or is qualified to be a district judge. The government's inability to locate suitable persons to fill these posts has been identified as a reason for the delay. But banker's feel that lobbies representing the interests of lawyers are resisting their establishment, as they fear a dilution

in the role of lawyers after suit filed banking cases are transferred from the civil court to the special tribunals.⁶

The Act was gazetted on 27th August 1993 and the Reserve Bank of India subsequently issued a circular to all bank chiefs on December 13th, asking them to identify cases to come up before the tribunals⁷. Banks are currently busy drawing up lists of suit-filed cases following the issuance of the Reserve Bank of India circular. In addition, banks such as Vijaya Bank have begun setting up special asset recovery branches- the first of these was set up in Bombay. Canara Bank too has plans to set up five such branches and a proposal to this effect is pending Reserve Bank of India clearance.⁸

The Act contemplates establishment of special tribunals for expeditious adjudication and recovery of debts due to banks and financial institutions. These tribunals will consist of only one person (the presiding officer) and shall be known as the debts recovery tribunals. All banking companies and corresponding new banks as defined in section "5" of the Banking regulation Act 1949, State Bank of India and its subsidiaries, the Regional Rural Banks and the Public financial Institutions within the meaning of section 4-A of the companies Act, 1956 shall benefit by the provisions of the Act. The Central Government is empowered to add to this list by issuing a notification in the official gazette. These tribunals will handle cases of default for Rs 10.00 lacs or such amounts as are notified by the government not being less than one lakh. The Act also provides for the appointment of a recovery officer who will be attached to the tribunal and who will discharge his functions under the general superintendence of the presiding officer. The Central Government will also establish one or more appellate tribunals to consider

appeals of persons aggrieved by order of the tribunals.

Chapter IV deals with the procedure to be followed by the tribunals. In accordance with these provisions, a bank will have to make an application for recovery of its debt from any person, to the tribunal of appropriate jurisdiction. On receipt of such application, the tribunal will give a notice and an opportunity to the defendant of being heard and thereafter shall pass such order as it may think fit to meet the ends of justice. The tribunal is also empowered to make interim orders (whether by way of injunction or stay) against the defendant to debar him from transferring, absenting or otherwise dealing with or any property and assets belonging to him without the prior permission of the tribunal. The Tribunal will endeavour to dispose off the application within 6 months from the date of its receipt.

The order passed by the tribunal will be appealable to the appellate tribunal. However no appeal shall be entertained by the appellate tribunal unless the appellant deposits 75% of the amount due from him as determined by the tribunal. Both the tribunal and the appellate tribunal will not be bound by the procedure of the code of civil procedure 1908, but shall be guided by the principles of natural justice and the provisions of the Act. They will also have power to regulate their own procedure and shall have the same power as is vested in a Civil Court under CPC in respect of summoning and enforcing the attendance of any person and examining him on oath, production of documents, receiving evidence etc.

The above Act will go a long way in facilitating expeditious recovery of the dues under sticky accounts of the banks. The simple procedure

contemplated under the Act as against the complicated procedure involving innumerable stages under CPC will save the claims of the banks from getting lost in the cobweb of the court procedures. The requirement of depositing 75% of the amount of the claim before filing any appeal will put an end to endless frivolous appeals. The Act proves to be land mark step and a beginning of the long awaited judicial reforms in this country.

While the Act introduces various progressive measures, it also suffers from certain deficiencies:⁹

a) Section 25, clause (a) provides for recovery of the amount of debt by attachment and sale of the movable and immovable property of the defendant. In other words, not only the property mortgaged to a bank but even the property not so mortgaged can be sold by the recovery officer. This may adversely affect the claims of other creditors, especially the unsecured creditors. Ends of the justice would be met if, in the first instance only that property which is specifically charged to the banks is attached and sold. Thereafter if still some amount remains to be recovered, the bank must share the proceeds of the remaining property of the defendant pro-rata with other unsecured creditors.

b) There is no explicit provision for recovering the debt from a guarantor though in view of the definition "debt" as given in the Act it may be possible to join the guarantor also as a defendant. However in order to place the matter beyond doubt, the words "including a guarantor" may be added after the words "from any person" in sec 19(1) as also after the words "of the defendant " in section 25 (a).

c) It appears from section 19 that separate application may have to be made to the tribunal by the banks and the financial institutions to recover their debts. In consortium financing

several banks and financial institutions participate in the loan. It should be enough if only one of the lenders files an application and the others are joined as co-respondents and their claims are determined and decreed in the same proceeding.

d) In so far as the creditors other than a bank is concerned there is nothing in the Act to restrain them from filing a case against the defendant in any Civil Court for recovery of their dues. Also the creditors have no recourse to the machinery under the Act. Under these circumstances, a very queer situation may develop in that these creditors may succeed in obtaining orders from a Civil Court which may at times, be in conflict with the orders of the tribunal. It is also likely that the banks may find themselves joined in these proceedings under Order 34, rule 1 of CPC and thereby dragged in the litigation initiated by the other creditors. The only solution to this problem would be to decide the claims of the creditors by the tribunal it self and the Civil Courts do not have jurisdiction over the claims of the creditors.

e) The Act leaves out the State level Financial Institution from its scope. The logic of this approach is not understood. The state level financial institutions also face serious recovery problems and need the same assistance as the banks especially the state IICs, and IDCs, who do not have the benefits of the special provisions on par with the State Financial Corporations Under the state Financial Corporations Act 1956.

f) The Act does not deal with a situation where the Industrial Concern (Defendant) is simultaneously faced with the proceedings initiated by a bank under the Act and the winding up proceedings initiated by other creditors under the winding up proceedings initiated by other creditors under the companies Act 1956. In the absence of regulating

and coordinating the two proceedings, it is likely that the orders passed by a winding up court and the actions of the official liquidator under the Companies Act may come in conflict with the orders of the Recovery Tribunal.

g) The Act also ignores the interests of the workers. As per Section 529 of the Companies Act 1956, the claims of workers of a company in winding up rank parri-passu with those of the secured creditors. The Act does not contain any such provision. Therefore if there is no winding up proceeding and the company's properties are sold by the tribunal, then the workers may be deprived of the benefit conferred upon them under Section 529.

Bank arrears today account for the largest single category of arrears in courts. The 1.5 million cases pending in various civil courts are likely to be transferred to the special tribunal involving an amount of Rs.10,000.crores.¹⁰ Steps should be taken to make the tribunals really effective to assist the banks in their efforts for prompt recovery.

The category-wise advances of outstanding and fallen overdues in respect of public Sector Banks as on September 1989-1990-1991 is given in Table 1. The amount of agriculture loans provided by Commercial Banks, Regional Rural Banks and Co-operatives and the amounts recovered by these Institution during the Seventh Plan (1985-1990) as well as during the subsequent 2 Years i.e., 1990-91 and 1991-92 is given in Table 2.

SECTORS	Amount Outstanding			(Rs. in crores) Amounts Overdue		
	SEPT	SEPT	SEPT	SEPT	SEPT	SEPT
	1989	1990	1991	1989	1990	1991
Large Industries	27,224	33,139	34,247	3,598	4,822	4,681
Small scale Industries	14,011	15,506	15,600	2,785	3,278	3,579
Agriculture	14,849	15,973	16,252	2,934	3,399	3,558
Other Priority Sector	7,854	8,430	8,691	2,291	2,618	2,778
All others	20,675	24,881	27,779	2,018	2,706	3,371
Total	84,613	97,930	102,480	13,645	16,817	17,967

TABLE 2

YEAR	Amount of agriculture loans		%(Rs. in crores) % of recovery to demand
	Disbursed	Recovered	
	1985-86	7005	
1986-87	8016	6765	56.46
1987-88	8429	7754	56.90
1988-89	9084	7685	56.16
1989-90	9801	6349	45.32
1990-91	8846	7576	54.09
1991-92	11199	7878	51.56

Source : Financial Express (Bombay), 26th January, 1994.

NOTES

1. "Culture of non-recovery in banks draws flak", The Business & Political Observer, Oct 26, 1993.
2. S.C. Dhall, "Need for concrete steps for loan recovery", Financial Express (Bombay), Jan 26, 1994.
3. R.M.Chidambaram, "Recovery management", Financial Express (Bombay), Oct 27, 1993.
4. M.J. Subramaniam, "Two years of banking reforms", Financial Express (Bombay), Nov 1, 1993.
5. Archana Rai, "Problem bank loans heading for recovery tribunals", The Economics Times (Bombay), Jan 23, 1994.
6. Ibid.
7. Ibid.
8. Ibid.
9. B.D. Ushir, "Bank Recovery Ordinance : A hasty step?", Financial Express (Bombay), Sept 8, 1993.
10. Supra, n. 2.

CRIME IN BANKS - FRAUDS

A general increase in crimes is noticed all round, particularly crimes involving violence. In the 25 years from 1953-1978, all India crime increased by 108% as compared to 76% increase in population.¹ Dacoities/robberies in banks in the whole of India was only 3 in 1973, but by 1991, the figure had risen to 116.²

A noticeable trend in the behaviour of the average criminal in modern times is that he is becoming more and more aggressive in the commission of his intended crime. He takes to violence more readily to counter any impediment to the completion of his plan. Bank employees are white collar workers dealing with white collar customers and together they constitute a 'soft' section of the community, holding large amounts of money in custody at the place. Thus they form a ready target for any determined group of criminals who would readily use violence if the need arose to knock away wads of currency notes of large value. The fact that currency notes are not specifically identifiable provides further inducement to criminals to resort to crimes in banks in preference to other areas involving other kinds of property.

Crimes in banks can be broadly classified as follows:³

1. Hold up within the premises of banks which amount to dacoity/robbery under the criminal law. These crimes involve marked violence sometimes extending to the causing of death also.
2. Burglary/theft which normally takes place in the quiet darkness of the night.

3. Fraudulent removal of money from the person of a customer in and around the bank premises by professional criminals who divert his attention by a variety of means and then commit the crime.

4. Fraud by outsiders who make use of forged documents to draw money.

5. Fraud by insiders i.e. bank employees who remove documents within the bank and fraudulently take away the money.

Crimes like robbery/dacoity and burglary/theft are visible and hence easier to prevent. It is easy to prevent these crimes by taking adequate physical security measures and making necessary security arrangements.

Frauds are less visible crimes and hence difficult to detect and investigate and this makes it difficult to recover the stolen or lost goods. In the large majority of cases they constitute cheating or other allied offences. Fraudulent or dishonest deception for retention of property will constitute cheating. Even if a deceived person omitted to do anything which he would have done but for such deception or was compelled to do something it will be cheating, if the omission or act is likely to cause damage or harm to that person or anybody in body or mind or reputation or property.⁴

It may also be added that deception may arise as a result of concealment of facts as much as by a dishonest representation. So in all cases of cheating intention of the accused person at the alleged time of deception is of importance. Even if there is no

dishonesty in the sense that a wrongful gain or a wrongful loss was not intended to be caused it may amount to cheating if fraud was committed. Fraud has not been defined in Indian Penal Code. Deception with a view to gain an advantage which is non-economic may well be regarded as fraud in certain circumstances. In bank transactions which are governed by Negotiable Instruments Act there is great mobility. The various steps in the transaction which takes place in quick succession and the fact that there are innumerable such transactions taking place in a bank give room for cheating. Very often forgery has also to be committed for cheating. Not merely executing or making any document but even altering it, or even making the real person to sign, seal, execute or alter the document may amount to forgery. Alteration will be forgery if, without lawful authority it is altered dishonestly or fraudulently. Even making a person really concerned to sign, seal or execute or alter the documents may amount to the offense of forgery, when it is done dishonestly or fraudulently.

Modern banking is fraught with tremendous risks. The rapid expansion of banking business and its growing variety has made it a challenging task for banks to keep control over their organisation. A major offshoot of this growth phenomenon is the laxity that has crept into the observance of stipulated procedures of the banks which are meant to safeguard the institutions interest in its dealings with the public. This laxity has provided a breeding ground for the perpetration of frauds on a massive scale, thereby saddling the banks with heavy losses and also bringing disrepute to their fair image. The massive expansion of bank business had led to a loosening of bank control mechanisms. The number of branches of commercial banks which stood at 8262 in June 1969 increased to 60690 in March 1992 an increase of 52428 branches over a period of 23 years i.e. an average annual increase of 2360 branches.⁵ Aggregate deposits of the banking system rose

from Rs.4641 crores in June 1969 to Rs. 239622 crores in June 1992.⁶ With regard to credit also, substantial increase has taken place from Rs.3599 crores in Jun 1969 to Rs. 147900 crores in June 1992.⁷

Between 1976 and 1993, 27317 cases of fraud involving Rs.707.14 crores were registered⁸ (details as per Table 1 and 2). There were 1599 cases of frauds reported by 28 public sector banks in 1991.⁹ Atleast 50 employees of public sector banks were convicted and 699 were given major/minor penalties for their involvement in frauds irrespective of the date of occurrence, the minister for finance informed the Lok-Sabha in June 1993.¹⁰

Analysis of frauds would show that it is not necessary for the bank staff to be detectives to keep a check on the perpetrators of these frauds but a careful observance of the prescribed procedures can certainly help in nipping the plans of these defrauders in the bud. Bankers do agree that the system of management of the business designed by the banks is adequate that adherence to it should normally not give rise to the various types of frauds being committed.

But the managers lament that the growth in business has been of very high magnitude; while at the same time the growth in manpower resources has not been equally matching. This apart, the complex nature which banks business has acquired has further perpetuated and compounded the problems of managers. A stage has come when practically everyday, fraud is committed in some part of the banking domain. The unparalleled state of frauds has not only made bank staff jittery but also jolted the confidence of the people in the banking industry.

TABLE 1

FRAUDS IN BANKS

Year	No. of cases	Amount (in crores)
1977	1018	4.76
1978	1422	7.38
1979	1414	15.14
1980	1594	8.40
1981	1891	20.34
1982	2065	19.44
1983	2343	33.29
1985	2178	113.69
1987	2148	49.85

SOURCE: Financial Express (Bombay), 19 June, 93

TABLE 2
BANK-WISE POSITION OF FRAUDS

Name of the Bank	1991		1992		Upto March '93	
	No. of frauds	Amount involved	No. of frauds	Amount involved	No. of frauds	Amount involved
1. Allahabad Bank	34	25.56	38	67.46	8	2.72
2. Andhra Bank	35	290.03	41	1028.75	19	116.45
3. Bank of Baroda	79	240.95	70	281.64	25	175.09
	*10	30.11	*5	30.07	*3	2.01
				1500 F \$		
4. Bank of India	90	689.03	154	701.75	36	147.81
	*6	38.53	*6	2355.83	*2	0.82
		4597787 Shs				
5. Bank of Maharashtra	12	742.29	31	298.63	2	0.54
6. Canara Bank	115	489.14	140	369.35	66	44.81
7. Central Bank of India	68	106.04	50	1311.66	26	89.25
8. Corporation Bank	19	6.64	14	16.47	8	36.54
9. Dena Bank	20	46.16	32	33.16	5	17.78
10. Indian Bank	56	223.73	65	319.93	10	2.99
11. Indian Overseas Bank	60	18.67	83	745.40	9	28.05

Name of the Bank	1991		1992		Upto March '93	
	No. of frauds	Amount involved	No. of frauds	Amount involved	No. of frauds	Amount involved
12.New Bank of India @	19	517.28	25	495.83	5	1.12
13.Oriental Bank of Commerce	7	80.25	6	26.66	-	--
14.Punjab National Bank	42	218.59	54	111.53	20	92.31
15.Punjab & Sind Bank	14	198.70	6	245.61	7	213.22
16.Syndicate Bank	116	381.85	96	202.38	47	38.24
17.Union Bank of India	65	46.05	44	47.45	12	4.06
18.United Bank of India	24	7.71	26	243.29	10	5.55
19.U C O Bank	57	492.18	39	4466.87	8	8.83
	2*				1*	20.36
20.Vijaya Bank	40	58.40	38	25.16	11	80.45
TOTAL:	996	4960.14	1063	13425.38	340	1129.00
				1500 F\$		

* Indicate frauds outside India
F\$ Fijian dollars (Fiji Currency), Shs represents Ugandan Shilling
@ Since merged with P N B

SOURCE: Times of India (Bombay), 13 March, 94

Bank frauds are not committed exclusively by outsiders. In fact a substantial number of them are committed in collusion with the employees of the banks. The rapid expansion of banks and the mass recruitment of employees has made it impossible to ensure that the moral aspect of an individual's personality is also evaluated while selecting. In the earlier days great emphasis was laid on the individual's character while recruiting him. Apart from the educational qualifications and intelligence, his moral habits were also enquired into. Mass recruitment of employees makes it extremely difficult for the recruitment bodies to assess the employee from the point of view of social anthropology.

A study of the frauds committed in major fraud prone areas has confirmed that frauds are committed not due to any lacuna in the system and procedures of the bank but due to non observance by the employee of the safeguards provided by the bank.¹¹ Frauds are committed after careful watch of the routine procedure in the functioning of the bank. In some cases deviation by staff from established procedures have proved to be dangerous.

The 34th report of the Estimates Committee submitted recently to the Lok Sabha had arrived at the conclusion that " neglect of well established procedures is the basic cause of most of the frauds ".¹² The top brass of the banks could not remain aloof from the charges of collusion. This was borne out by the fact that Reserve Bank of India received 47 complaints up to 1990 against top executives of the bank of which 38 were serious enough to warrant investigations while the rest were substantiated.¹³ Concerned

over the increasing amounts lost the committee expressed its " unhappiness over the complacent attitude of the management of the banks and the government in the matter of frauds ".¹⁴ The committee also feels that in case of frauds, which result in substantial financial loss to the government, top persons are allowed to go scot free because of their clout rather than being subjected to exemplary punishment.¹⁵ The instrument in preventing frauds 'internal audit' has been seen in poor light by the committee which cited the case of State Bank of Hyderabad where a fraud of Rs. 1.48 crores was not detected even though the branch had been audited six times by the banks internal auditors, once by a firm of chartered accountants and for the eighth time by officials of the State Bank of India.¹⁶ The committee examined Central Bureau of Investigation (CBI) representatives who admitted that there were inevitable delays and that 70 to 80 months elapsed before a major fraud could be investigated (currently, a CBI probe is on into the massive Rs.2000 crores a year racket involving the fraudulent encashment of crossed cheques and other instruments in the Kalbadevi area of Bombay).¹⁷

According to RBI officials, frauds are generally committed in the area of misappropriation of cash / remittances, fraudulent encashment of negotiable instruments, misutilisation of discretionary limits, non- observance of prescribed norms in granting credit facilities opening/issue of letter of credit, bank guarantees and foreign exchange dealings.¹⁸

The opening of new accounts is one area where great caution needs to be exercised. Opening of account no doubt increases the business of the bank. However every possible precaution has to be taken to ensure that it does not turn into a vulnerable source for commission of fraud, tax evasion and hide-out for black money. Instances are not

wanting to confirm that through accounts opened in assumed or fictitious or non existing names, persons collect the intercepted cheques, drafts, dividend warrants etc., and also invented fake drafts and thus made unlawful gains.

Though banks inter-se-contest, litigate and fight against each other on the issue as to who has to bear the loss, the banking system thus suffers and innocent persons whose documents are intercepted are put to hardship and person committing such frauds do go scot free.

Section 131 - A and 131 of the Negotiable Instruments Act affords protection to a limited extent to a collecting banker. In the words of late Justice M C Chagla in *Bapulal Prem Chand V/S North Bank Limited*¹⁹ - "In my opinion there is no absolute and unqualified obligation on a bank to make inquiries about a proposed customer. I agree that modern banking practice requires that a customer should be properly introduced or in other words the bank should act on the reference of someone whom it could trust. Therefore perhaps in most cases it would be prudent and wiser for a bank not to accept a customer without some reference. But I am not prepared to go so far as to suggest that after a bank has been given proper reference with regard to proposed customer and although there are no suspicious circumstances attending on the opening of the account, it is still incumbent upon the bank to make further enquiries with regard to the customer.

The main areas in which frauds are committed are outlined below:²⁰

1. Instruments are stolen and these stolen instruments are then deposited in the bank by

opening a fictitious account. The proceeds are then collected by the bank and the funds are fraudulently withdrawn by the depositor.

2. Remittance of funds are another area where frauds are committed by the employee or by outsiders in connivance with the employees. Without the actual receipt of funds the instruments are written, signatures of officers forged and the instruments despatched to the beneficiary branch. Upon credit to the account and fraudulent withdrawal of the amount at the beneficiary branch, the transfer instruments and connected documents are destroyed.

3. Demand drafts are intercepted in postal transit, the name of the payee chemically changed, account payee branding and crossing cancelled to make withdrawal easy. Now a days demand drafts are being delivered from the stationary department to the bank branches by trucks and vans. These parcels are intercepted in transit and the form books are stolen. It is necessary to verify the consignment when it is received at the branch to detect such pilferages. These stolen forms are otherwise used to commit frauds.

4. One of the main areas in which fraud is committed by the outsiders is the stocks charged to the bank. When the stock statement is submitted the value is sometimes inflated and unless the Field Officer is careful in the verification of these stocks, the borrower may be able to draw funds beyond the value of the security charged to the bank.

5. In the accounts of companies there will be numerous credits. There have been instances where employees have replaced the credit slips of the companies with slips for credit of some other convenient account. The credit is then withdrawn at an opportune time. Another ingenious method has been to slit the credit, one meant for the company account

and one for an account which could facilitate easy withdrawal.

It is extremely necessary that bank procedures are strictly adhered to so that chances of frauds are minimised. In fact the deficit, in manpower resources in branches have led to books being imbalanced, entries remaining reconciled. This position is exploited by unscrupulous employees who collude with criminal elements of the society to perpetrate these frauds. It is necessary that staff positions in branches are strengthened.

RBI analysis show that an average embezzler within any bank has certain identifiable traits, some of which include being under debt and living beyond his means. They are often speculators on the stock market and are either compulsive gamblers or alcoholics or involved in any other dependency, which needs ready money to be met. The RBI panel on frauds has suggested sweeping changes. The recommendations of the committee which was headed by Mr.A.Ghosh, former Deputy Governor of RBI, had been adopted in August 1992 and banks asked to implement most of the recommendations immediately.²¹

With the great increase in intermediation in the financial sector, the committee feels the need for greater vigilance in the functioning of banks to prevent frauds.²² Since the corporate sector has ready access to fund markets in the country, the monitoring of these accounts should be stepped up. The committee believes that large frauds are possible only when there is some kind of collusion between the outsiders and the employees of the banks.²³

The committee has emphasised the need that the Chief Vigilance

Officers in public sector banks should enjoy greater autonomy and independence. It has also urged that commercial banks should have well laid down loan policies. It is believed that banks should have detailed investment policies giving detailed features of investment portfolio management.²⁴

The Estimates Committee of Lok Sabha in its report on prevention of frauds in nationalised banks, tabled in Lok Sabha by its Chairman Dr. Krupasindhu Bhoi has urged the Finance Ministry and the Reserve Bank of India to issue necessary comprehensive guidelines and ensure their effective implementation. It said, the committee was not convinced with the agreements advanced by the Finance Ministry that the position was not alarming because the ratio of defrauded amount to working funds was negligible and that frauds do supervene even in the most advanced countries.²⁵ Stating that the complacent attitude of the bank managements and the government in the matter of frauds was a condemnable one, the committee chided the government for not making any serious efforts to bring down the number of such cases and recover the defrauded money.²⁶

The committee said the complacent attitude of the government was palpable from the fact that almost all cases reported since 1987 involving Rs. 100 lakhs and above in each case were at various stages of investigation and no prompt action could be taken against the guilty persons.²⁷ The committee said that it was the responsibility of the higher authorities to ensure by periodical checks and inspections that the prescribed procedures were strictly followed and the higher authorities do not escape responsibility for failure to do so.²⁸

It noted with concern that of the various categories of fraud, cheques/drafts operations accounted for maximum number of frauds whereas loans and advances occupied the first position if the amount involved in the fraud was taken into account.²⁹ It also noted with concern that the amount involved in foreign exchange category which had a limited clientele is the second highest.³⁰

Listing out preventive measures for checking frauds in banks, the committee said independent confirmation of addresses of account holders should be done in all cases and not only in doubtful cases. Besides all incoming and outgoing instrument should be serially numbered and entered into registers at date stage.³¹

It also suggested that all loan applications should be scrutinised on merits and examined critically under the laid down norms without succumbing to pressure and said that proper credit appraisal should be done. A uniform (not too rigid) detailed lending policy should also be formulated with internal loan review department.³²

The committee said that inter branch reconciliation of account is a highly fraud-prone area and causes delay in detection of frauds and as such should be given topmost priority. It also urged the bank management to take up with the unions the need for computerisation and automation of the banking operation so that scope for frauds was reduced.³³

Referring to control mechanism, the committee favoured a uniform internal audit system with uniform terminology applied equally to all banks. There is

also need for Comptroller and Audit General of India to be closely associated with the audit of the banks, the committee added.³⁴ It did not accept the stance that such an audit by CAG would violate confidentiality of relationship between bank and customers. It also called for greater transparency in the final accounts and balance sheets of various banks as this would clear picture and position concerning frauds and bad and doubtful debts.³⁵

The committee also recommended the setting up of a separate division in the Central Bureau of Investigation (CBI) for investigation of bank frauds. It said that such a wing would be set up in the CBI on the lines of the serious Fraud Office of Britain. The proposed division of the bureau should be empowered to investigate cases against the high functionaries of the banks.³⁶

The committee also called for the setting up of special courts or tribunals to have economic offences investigated for trial. The tribunal should be empowered to confiscate or freeze immediately the assets of economic offenders including bank employees involved in frauds, misappropriation or embezzlement.³⁷ For this purpose, necessary amendment in the relevant act or law might be made. The committee also suggested that the RBI bring all the overseas branches of Indian banks under the umbrella organisation.

The committee noted that most of the frauds were perpetrated on banks by employees either on their own or in collusion with outsiders. It was however disquieting to note that instead of awarding exemplary punishment and initiating criminal proceedings, the delinquent officials were awarded either very little or no punishment. It was

only in very few cases that officials were dismissed or removed from service. In a few other cases the committee observed that the officials were allowed to resign taking a lenient view. In yet some other cases, no action was taken as the officials were at the verge of retirement. The committee has therefore recommended that as soon as a fraud or any irregularity comes to notice, the suspected officials should be rendered innocuous the same day. They have also suggested that a system of group accountability should be evolved.³⁸

Top bankers are of the view that the Damocles sword of a CBI inquiry hanging over the heads of the staff kills the enthusiasm even of honest staffers who would shy away from taking decisions.³⁹ To counter this they prefer a mechanism minus the CBI to probe and handout punishments if necessary. Some of them hold the view that banks are in a business with higher chances of risk and the best they can do is to minimise the damage since it cannot be eliminated altogether.⁴⁰

As the fraudsters become more and more sophisticated, banks have to be constantly on the guard to keep a leap or two ahead of them.

NOTES :

1. C.V.Narasimhan, "Hold - ups and other crimes in Banks"(Course on Security management in Banks - A.P Police Academy), 1992, P 5.
2. Ibid.
3. Id. at 6.
4. N.T. Vanamamalai, "Crimes in Banks" (Course on security management in Banks - A.P. Police Academy), 1992, P 26.
5. Moin Qazi, "Bank frauds : The growing menace", Financial Express (Bombay), Jan 19, 1993.

6. Ibid.
7. Ibid.
8. Krishna Murthy Andavolu, "Frauds galore in Banks", Times of India (Bombay), Mar 13, 1994.
9. Supra, n. 5.
10. Ibid.
11. Ibid.
12. Supra, n. 8.
13. Ibid.
14. Ibid.
15. Ibid.
16. Ibid.
17. Ibid.
18. Ibid.
19. AIR 1946 Bom 482.
20. Supra, n. 5.
21. Supra, n. 8.
22. Supra, n. 5.
23. Ibid.
24. Ibid.
25. "Bank fraud - The quest for an effective deterrent", Business Standard (Calcutta), Dec 30, 1993.
26. Ibid.
27. "Govt criticized for bank frauds", The Statesman (Calcutta), Dec 10, 1993.
28. Ibid.

29. "Bank frauds siphon off Rs. 512 Cr", The Economic Times (Bombay), Dec 10, 1993.
30. Ibid.
31. Supra, n. 27.
32. Supra, n. 29.
33. "Cell to probe bank frauds mooted", Financial Express (Bombay), Dec 10, 1993.
34. Amitabha Sen, "Mismanagement in banks exceed RBI estimate", Business Standard (Calcutta), May 31, 1992.
35. Ibid.
36. Supra, n. 33.
37. Ibid.
38. Ibid.
39. Supra, n. 8.
40. Ibid.

AUTONOMY FOR INDIAN BANKS

One of the biggest drawbacks of the Indian banking system has been its lack of operational flexibility. Almost every operation is subjected to some statutory control or government guideline, such that even administrative matters are not considered to be within the purview of internal management¹.

When the banks were nationalised and brought into public sector, the ownership was acquired by government. Alongwith ownership the government also took up certain functions which involved direct intervention in management at the floor level. In due course of time, common rules / service conditions etc. came to be introduced for the purpose of uniformity among the banks. The compulsions of achieving social banking goals prompted the government to introduce guidelines in detail covering most aspects of day to day operation. All these were perhaps justifiable under conditions of a somewhat over regulated and non-transparent system. But over a period of time over regulation had proved counter productive.

This has in effect killed initiative and narrowed down the options available to both borrower and depositor. Worse still, politicians and bureaucrats are known to misuse their powers and exert undue influence on day - to - day decisions on loans and credit granted to clients.

Now competitive and dynamic banking demands a fair degree of flexibility in the decision making processes subject to certain norms and safeguards. These

are designed to check irresponsible lending, improve the internal strength of the institution and ensure profitability in a manner that the banking sector is able to meet the changing needs of the economy.

The recent guidelines regarding norms pertaining to capital adequacy, income recognition and provisioning have imposed tremendous strains on expansion and profitability of banks. This coupled with opening up of banking sector to private banks as also foreign banks make the issue of granting autonomy all the more relevant. It is vital for banks to have greater freedom to evolve a suitable professional management to face the tougher competitive environment. The present restrictions give little leeway for inducting the required type of manpower. Lack of internal autonomy has restricted the freedom of each bank to effect recruitment, placement, promotions etc., of the right type of skilled personnel. While many banks have adequate or even surplus staff in terms of numbers, there is dearth of staff of the right skills. The restrictions on annual growth of the staff strength have been imposed uniformly in all public sector banks. But there are practical difficulties of following "straight jacket formula" which imposes uniform type of conditions for all banks which, in fact, have varying requirements².

The Committee on Internal Autonomy to public sector banks headed by special secretary, R V Gupta, has made several recommendations which are expected to help banks expedite decision making in crucial areas while competing with private sector banks³. Though exact details of the recommendations are not known, sources said the committee had advocated greater autonomy for Bank boards to facilitate quicker decision making on important issues⁴. There are several areas where public sector banks are severely handicapped when compared with their counterparts in the private

sector, for instance - all recruitment by the public sector banks have to be through the Banking Services Recruitment Board (BSRB). At present banks cannot make fresh recruitment or create a specialised post without seeking permission from the banking division of the finance ministry following which the whole process is set in motion through the (BSRB). Often this is a time consuming process and key posts at senior levels remain unfilled for months. In contrast, private banks proposed by UTI, HDFC and others have nearly completed their recruitment at various levels, including directly from reputed management institutes. Sources said the Gupta committee has gone into the relevance of BSRB in the background of the financial sector reforms⁵. In fact the Narasimham committee has also said that the usefulness of centralised recruitment through the BSRB should be reviewed and assessed against Bank specific recruitment schemes⁶.

According to the Narasimham committee, one factor contributing to the weakening management systems is the inability of banks to recruit their staff directly and the rigidities that have prevailed in the system, of reward and punishment⁷. The committee therefore proposes that instead of having a common recruitment system, banks should be free to make their own recruitment of officers⁸. There is thus, in the committee's view no need for setting up a Banking Service Commission for centralised recruitment of officers nor for their recruitment as at present through the BSRB⁹. The committee however, predicates this recommendation on the assumption that banks will set up objective, fair and impartial recruitment procedures. As regards clerical grades, the present system of recruitment through BSRB could continue but urged that the appointment of the chairman of these boards should be left totally to the coordinating banks¹⁰.

The discussion paper on financial sector reforms circulated by the finance ministry says banks themselves can evolve recruitment policies to ensure certain broad based social concerns like reservations are honoured¹¹. There is also the view that profit making banks should be automatically allowed to create and fill specialised posts in view of the growing competition they will face from the private banks¹²

In emphasising the need for greater functional autonomy, the Narasimham committee called for depoliticising the appointment of the chief executive (CMD) of the banks and the boards of the banks and ensuring security of tenure for the CMD¹³. The committee believes that professionalism and integrity should be the prime consideration in determining such appointments and while the formal appointments have to be made by government, they should be based on a convention of accepting the recommendation of a group of eminent persons who could be invited by the governor of the RBI to make recommendations for such appointments¹⁴.

In 1969, when banks were nationalised, the principles enunciated by the government stressed that all appointments would be based on professional merit. However, over the years, appointments came to be made on the basis of services rendered or favours expected.

The other recommendation of the Narasimham committee is concerned with the top management structure¹⁵. All nationalised Banks, irrespective of their size have a similar type of management structure namely board of directors. As regards the board of banks the committee indicated that their primary function should be to lay down the

broad financial policy of the bank concerned and set corporate goals and review performance¹⁶. Boards, in their view should not get involved in day to day operations. These are the primary responsibility of the chief executive and his senior colleagues acting in accordance with the policies laid down by the board¹⁷ Another aspect is that at present, boards of public sector have nominees both of the govt. and of the RBI. The committee feels that as long as the government owns the banks it would perhaps be necessary to have a representative of the government to take care of what, one might term, the "proprietary concerns" but there is no need for the representation of the RBI on the board so as to avoid possibility of conflict of interest¹⁸.

The government in consideration of the committee's views wants the RBI to withdraw its nominees from the boards of the nationalised banks in order to ensure greater autonomy to the bank managements. This has become necessary following the liberalisation of the banking industry with the entry of additional private, Indian and foreign banks. This larger autonomy for the public sector managements has been one of the major demands of the Indian Bank Association and now, the finance ministry itself is piloting this move to fasten the process of reforms in the financial sector.

According to the present thinking of finance ministry, the government, as the owner, must continue to exercise proprietary control, at the same time the govt. has to ensure full operational autonomy to the managements, as is the case in countries like France¹⁹. There is already a substantial delegation of authority in operational matters such as raising of funds, investments and making of advances. Presently there are only a few matters relating to overall staff strength and creation of posts where the general guidelines lay down the maximum limits of expansion or where specific approval of

government is required. These guidelines and limits have been placed so as to control the excess proliferation of staff as there is a general perception that banks are overstaffed. The Finance Ministry has made a thorough review of the situation taking into account the changes that have so far taken place in the economy and consequently in the banking industry. It is now being felt that bank managements including their boards should be held fully accountable for the performance of their institutions in all respects and in order to make this accountability effective and transparent, the govt. should not appoint its officers in the boards of banks²⁰.

In the opinion of Economists and Financial Experts, autonomy of banks has to be closely linked to accountability over performance²¹. Such autonomy should cover aspects of internal management such as institution of a system of rewards and punishment and more importantly decisions relating to micro-credit and investment as well as geographical expansions²². Similar sentiments were echoed by the noted Economist and former Governor of RBI, Dr.I.G.Patel²³. He also stated that the economic reforms announced by the govt. would not produce the desired results if political considerations were allowed to influence fiscal processes²⁴.

The Central Finance Minister, Dr. Manmohan Singh has also gone on record saying that "over-centralisation and excessive bureaucratisation have proved to be counter-productive"²⁵. In his view the financial system in the country has developed certain "rigidities and weaknesses " that need to be urgently addressed by ensuring greater competitive efficiency and operational flexibility²⁶.

This is in keeping with the postulate of the M.C.Kinnon Shaw-Maxwell

hypothesis : "Excessive intervention in the financial system leads to financial repression and comes in the way of Financial intermediation"²⁷.

Accordingly to the Narasimham Committee, regulations for the banking sector, if any, ought to be framed only by the RBI and not by a multiplicity of government bodies²⁸. From time to time the relevance of the guidelines may be reviewed by an independent body with a view to ensuring greater independence and autonomy of banks. The reviewing authority could be a quasi-autonomous body set up under the aegis of the RBI but which should be separate from its central banking functions, suggests the committee²⁹.

While this would ensure efficient functioning in a market-friendly environment, banks need also to inculcate a culture of self-dependence that would create a sense of primary responsibility. For this, due emphasis has to be placed on internal audit and inspection as suggested by the Narasimham Committee³⁰.

Former RBI Governor, S. Venkitaraman, disagrees with the recommendations that the supervisory function of the RBI should be delinked from its regulatory function. According to him, it is crucial to conduct "Onsite" supervision rather than "Of-site" regulation³¹.

The complexity of functions in the banking system also demands that the sole responsibility for the profitability and efficiency of banks must rest upon their managements. The latter ought to be able to adopt to changing conditions and innovate strategies to steer through crisis situations which might place serious strains on bank

profitability. Such strains might arise out of policies prescribed by authorities outside the ambit of the banking sector.

However, it is crucial to ensure a right balance of autonomy and accountability. As the National Confederation of Bank Employees (NCBE) has argued "Accountability without autonomy is tyranny and autonomy without accountability is anarchy"³².

According to G. P Tategaonkar, Executive Director BOI - "A beginning has been made in providing autonomy for the nationalised banks by way of Memorandum of Understanding signed between the banks and RBI"³³. Memorandum of Understanding is a self regulated discipline imposed on the nationalised banks for infusion of capital in the light of new stringent prudential norms and capital adequacy ratio³⁴. MOU covers a number of areas in which banks have freedom to operate with a view to reach viable and sound financial position in their operations in the new future.

The commitments under MOU can be fulfilled only under a system of strategic planning covering the medium and long term action points. It is for the banks to devise the strategies for sourcing and mobilising low cost resources, to ensure deployment by balancing risks and returns and to acquire the required professional skills, technology and tools for maximising efficiency and productivity, leading to higher profits. All these can be done only when the banks are assured of a measure of internal autonomy.

NOTES

1. Rajendra Singh, "Autonomy for Indian Banks" Hitwada (Nagpur), May 24, 1992.
2. G.P. Jategaonkar , "Autonomy", IBA Bulletin, P 82, Jan 1994.
3. M.K.Venu, " More autonomy for banks suggested", Business Standard (Calcutta), Feb 11, 1994.
4. Ibid.
5. Ibid.
6. Report of The Committee On The Financial system, (M Narasimham, Chairman), Nov 1991, P 94.
7. Ibid.
8. Ibid.
9. Ibid.
10. Ibid.
11. Supra, n. 3.
12. Ibid.
13. Supra, n. 6. P 98.
14. Ibid.
15. Supra, n. 6. P 95 -97.
16. Ibid.
17. Ibid.
18. Ibid.
19. Nitya Chakravorty, "Govt Wants RBI nominees out of banks boards", The Hindustan Times (New Delhi), Dec 18, 1993.
20. Ibid.
21. Supra, n. 1.
22. Ibid.

23. Ibid.
24. Ibid.
25. Ibid.
26. Ibid.
27. Ibid.
28. Supra, n. 6. P 130 - 133.
29. Ibid.
30. Ibid.
31. Supra, n. 1.
32. Ibid.
33. Supra, n. 2, P 83.
34. Ibid.

SUPERVISION AND REGULATION

The banking system serves a vital intermediary role in a market oriented economy by allocating a scarce resource, capital, to its most efficient and productive use¹. Efficient financial systems help countries to grow, partly by mobilising additional financial resources and partly by allocating these resources to the best uses. There is a two-way relationship between a well functioning economy and a well functioning banking system. If the economy gets into trouble because of a cyclical downturn, the banks become the shock absorbers. As banks are important elements of the infrastructure of today's societies, so is bank supervision.

Supervision can be seen as having several broad aims². First, to protect the small depositor from mismanagement or fraud. Secondly, to protect the public from what has been called systematic risk. This refers to the possibility that the failure of one bank could lead to the failure of several banks and a lack of confidence in the entire system. Thirdly, some countries have national deposit insurance systems or otherwise implicitly undertake to protect bank depositors. In these countries, supervision serves to protect the insurance fund or the governments own fund from loss.

It has long been recognised that banks, are within a free market setting, prone to failure. For this reason various regulatory initiatives have been taken from time to time to limit potential sources of instability. Banks have been required to raise their capital ratios, maturity - mismatching - the extent to which the maturity of assets exceeds that of liabilities - has been subject to supervisory review ; more

comprehensive disclosure of bank's financial condition has been required ; and the regulatory environment has also favoured the securitisation (or repackaging in marketable form) of an increasing proportion of bank assets³. Nevertheless, the underlying fragility of bank remains and the possibility of contagious disorders sparked off by some unexpected event continue to be a source of anxiety to regulatory authorities. Accordingly, most national banking systems have in place extensive protective mechanisms embracing deposit insurance, access to official liquidity support and even recapitalisation and nationalisation schemes, designed either to support troubled banks or to safeguard depositors in the event of failure⁴.

Worldwide the competitive position of banks has been deteriorating in response to several adverse developments⁵. In the first place, banks have faced increased competition on the asset side of their balance sheet as commercial paper, corporate bonds and other forms of direct financing have displaced conventional bank lending. Simultaneously, they have faced a squeeze on the liabilities side. The dismantling of deposit interest controls in the USA and Japan, and the introduction of interest paying current accounts elsewhere (depriving banks of a major proportion of their traditional free funding) has pushed up bank's own borrowing costs⁶. This trend has been further aggravated by a marked decline in banks credit standing over the last decade and an associated rise in the cost of wholesale funds⁷.

The financial sector, the most important constituent of which is the banking system, has, therefore, traditionally been an area of regulatory interest the world over. The case for regulation of the financial system rests on the obvious ground that its solvency, safety and soundness is of paramount importance for stability and orderly

growth of the economy. The institutional development of the financial sector can only take place if the depositing and investing public have confidence in the system. Installing such confidence is thus a major promotional objective of regulation. Regulation is thus designed to ensure efficiency of the system, prevent concentration of business in it and protect depositors and investors from the vulnerability of financial institutions to market failure, mismanagement and fraud⁸.

In major banking centers, organisational structure varies quite considerably⁹. Some countries such as the UK and Italy, place responsibility of supervising banks quite clearly within the central bank. Others, including Canada and Switzerland have established supervisory authorities removed and apart from the central bank. Some such as Germany, the USA and Japan, have a mixed system with the central bank sharing supervisory responsibilities with separate government agencies. Indeed, each country has its own unique set of financial, institutional and legal frameworks. In this context what perhaps is more important than where the supervisory authority lies is the extent of supervisory powers and its independence¹⁰.

The core task in supervision is the supervision of operating banks by using specific techniques. Ideally, a supervisory system should allow for both "on site" and "off site" supervision¹¹. These are however, vehicles or means, used by the supervisor, not ends in themselves.

In "off site" supervision, the supervisor uses prudential reports from the banks and direct contact with the bankers to review performance to issue individual recommendations or directives. The task of off-site surveillance is to

review and analyse reports and statistical returns. Off-site monitoring can sometimes provide indications of problems, particularly in the interval between on-site inspections. Such reports can be used to identify trends in, say, earnings or provisioning levels, not only for particular institutions but for the banking system as a whole. Such aggregate information on the health of the industry is of use not only to the supervisor but also to economic policy makers within the government. A basic pillar of a good off-site surveillance is a proper bank rating system. The supervisor checks periodically on the basic elements of each bank's health and gives it a rating for each aspect of its state as well as an overall rating. The elements used as a basis to rate bank's management are competence, leadership, compliance with regulations, ability to plan, ability to react to changes in the environment, quality of policies etc¹².

On-site inspection has a somewhat different role. It provides the supervisor with an independent check on the operations and condition of the bank. Such inspections can be used to check the bank's internal control procedures and to establish whether the staff is adhering to laid down procedures and credit policies. The inspector can review at close range the management's competence, the quality of the accounting systems and follow up potential problems identified in off-site reviews. In many countries the supervisory function is rather small and on-site inspections occur infrequently or are specifically targeted at weak institutions. Other countries, the US for example rely very heavily on inspections arguing that they offer the best possibility for identifying potential problems and have devoted sufficient resources to this function to be able to visit banks at least once a year. Regardless of the mix of on versus off-site supervision one uses, an essential element in successful supervision is frequent contact with the bank at all levels.

From the above it is clear that while there exists a convergence of views on the goals of bank supervision i.e. to promote safe, stable and efficient financial system, supervisory structures vary across the world. Broadly there are 3 approaches¹³

- i) separation between regulatory and supervisory bodies, like in Germany
- ii) regulatory and supervisory functions under the same agency such as USA, UK and India and
- iii) separate regulatory and supervisory institutions working in close co-ordination such as in France with on-site inspections carried out by the officials of the central bank.

In India's case, despite the recent events which have exposed the existing supervisory system, there is no need to "reinvent the supervisory wheel" as the Governor, RBI has observed¹⁴. "What is perhaps needed, " he added, " is the strengthening of the system in terms of supervisory policies, focus and skills"¹⁵. While retaining the strength of the central monetary authority, the revamped system of supervision should be able to devote exclusively to the area of supervision and provide effective supervision in an integrated manner¹⁶.

As in other countries regulatory system in India also accords primacy to the protection of the depositors and investors interest and, for this purpose, the RBI has been statutorily vested with the extensive powers of regulation and supervision of banks and non-bank financial intermediaries to ensure adherence to the various legal provisions and administrative directions or guidelines prescribed from time to time with

regard to asset portfolio and other aspects of business. With nationalisation the public sector banks have also been brought under the administrative and regulatory review of the government leading in the process to a measure of duality of supervisory control over them.

According to the Narasimham committee report while regulation in terms of satisfying certain rules and norms of operation and supervision to ensure compliance with such rules and norms is necessary and justified, the situation in India as far as the banks are concerned is that regulation and supervision have extended to aspects not directly connected with the depositor's funds¹⁷. Detailed branch licensing is an example. Various aspects of management of banks including matters of internal organisation, operational procedures and administrative matters have come within the purview of regulation and supervisory control¹⁸. There is hardly any aspect of operations and management which is not covered. "The system in consequence has become over regulated and over administered and has placed an undue burden on the supervisory authority"¹⁹. This degree of regulation and supervision has still not been able to prevent a deterioration in the health of the system and in assets quality. Part of the reason for such deterioration is the measure of administrative direction in the matter of assets deployment, the perceptions of targets for lending and the detailed administration of interest rates which has led to bank receiving less than market related rates on their investments and on a significant portion of their credit²⁰.

The committee believes that the task of supervision is to ensure compliance with such prudential regulations which should be directly concerned with the protection of depositor's or investors interests and with ensuring adequate balancesheet

quality²¹. Emphasis should be placed on prescription of prudential norms and statutory requirement relating to asset quality such as minimum liquidity ratios, qualitative and quantitative checks on credit portfolios, stipulation of risk asset limits, checks on individual credit exposure, perception of well accepted and transparent accounting practices, provisioning and disclosure statements as well as with respect to capital adequacy²². According to the committee the system should be impersonal and objective and be based on self regulation which would call for strengthening the management quality and the internal inspection and internal audit systems of banks.²³ The main responsibility for ensuring compliance with the prudential norms would thus be with the banks themselves who should send periodic returns to the supervising authorities on these aspects.

Accordingly, the committee advocates off-site enforcement of rules with on-site inspection being occasional and designed to assure the supervisory authority that internal audit and inspection procedures such as credit appraisal systems are in proper place and adequate and conform to well laid down norms and that regulations are being properly complied with.²⁴

The committee is of the firm opinion that the duality of control over the banking system between the RBI and the banking division of the Ministry of Finance should end and that the RBI should be the primary agency for the regulation of the banking system.²⁵

Taking an overall view, the committee has recommended that while RBI would normally be the appropriate agency for regulation, its supervisory function should be separated from the more traditional central banking functions and that a separate

agency which would be a quasi - autonomous Banking Supervisory Board under the aegis of Reserve Bank be set up²⁶.

In view of the widening and deepening of the financial sector and the emergence of many new types of functional institutions, the committee proposes that the Board should have supervisory jurisdiction not merely over the banking system but also over the development finance institutions, non-bank financial intermediaries and other para banking financial institutions, such as those which accept deposits or float bonds from the public.²⁷ With the financial sector getting more diversified and more closely interdependent, there is great advantage in having a single integrated system of supervision so as to avoid segmentation of the market for supervisory purposes and the associated problem of inadequate coordination between different supervisory authorities covering the financial system²⁸.

The government and RBI are understood to be working towards determining an optimal model for supervision of the Indian financial system²⁹. The model envisages the setting up of a Supervisory Board within Reserve Bank which would attend exclusively to supervisory functions. The Board For Financial Supervision (BFS) which is expected to become operational soon will ensure compliance of guidelines for credit management, asset classification, income recognition, capital adequacy, provisioning and treasury operations. Dr. Rangarajan said emphasis would be given on developing technical and reporting competence of supervisors to detect operational weakness and communicate their findings to the BFS quickly.³⁰ It is understood that the Board will have an advisory committee consisting of persons of eminence drawn from different walks of life and with knowledge and experience in the economic and financial system.

Such a supervisory structure alongwith concomitant shifts in supervisory focus and policies could constitute a major step towards strengthening the institutional foundation of prudential regulation and supervision of the Indian financial system.

In conclusion it may be observed that reform of supervisory practices can be effective and successful,if supervision is viewed as a back-up support system for the banking industry. Banking supervision cannot be a substitute for prudent bank management. A strengthened supervisory system must be accompanied with an equally improved system of banks own internal control. " The first line of defence against financial distress and banking crisis is the quality and character of management within the banks themselves. Strengthening supervision policies and a vigilant control system together can ensure protection of the safety and soundness of the banking system and reduction of systematic risks " says Dr. Rangarajan.³¹

Regulation and supervision are not panacea, but they are necessary pillars to have a strong financial system and limit the damages caused by mismanagement and make macro policies effective.

NOTES

1. K. Kannan, "Supervision and Regulation", IBA Bulletin, P 60, Jan 1994.
2. Ibid.
3. Id. at P 61.
4. Ibid.
5. Ibid.
6. Ibid.

7. Ibid.
8. Report of The Committee On The Financial System, (M.Narsimham, Chairman), Nov 1991, P 125.
9. Supra, n. 1 P 61.
10. Ibid.
11. Ibid.
12. Ibid.
13. D.G.Gupta, " Tasks for RBI Supervisory Board", The Hindu (Madras), Sept 9, 1993.
14. Kharak Singh Kaira, "Need to give RBI more teeth : Rangarajan", The Business and Political Observer, Feb 11, 1994.
15. Ibid.
16. Ibid.
17. Supra, n. 8. P128.
18. Ibid.
19. Ibid.
20. Ibid.
21. Id. at P 129-130.
22. Ibid.
23. Ibid.
24. Ibid.
25. Id. at P 130.
26. Id. at P 131.
27. Ibid.
28. Ibid.
29. "RBI Supervisory board to be operational by year end", Financial Express (Bombay) Oct 19, 1993.

30. Ibid.

31. Supra, n. 13.

MECHANISATION AND COMPUTERISATION

In the last decade Indian commercial banks added between 2500-3000 branches per year¹. In the span of ten years both the business activities and the manpower deployed increased manifold. Consequently all the banks are bulging with men, branches and number of accounts. The changes called for operational, strategic and structural adjustments. Mismatch of these adjustments have created a number of problems and disfunctionalities like deteriorating customer service, poor house keeping, deteriorating quality of portfolio and in effective management information system.

In the coming decade, in view of the projected growth of business and new demands on the banking system, these problems are likely to aggravate further and unless adequate steps are taken without further delay, the situation may go out of control. It is felt in expert quarters that the above problems cannot be tackled by marginal operational modifications, they require policy level modifications calling for fundamental changes in work technology and related structural and system changes². Recent attention towards mechanisation and computerisation is the result of this concern and it is rightly felt that changes in work technology can be brought about by the judicious use of micro, mini and main frame computer at various levels of division making tiers³.

The first blueprint for computerisation in the banking industry was drawn up in 1983, but it is only in the last three years that nationalised banks have examined the issue seriously.

In 1989, a committee headed by the present Reserve Bank of India (RBI) Governor, C Rangarajan drew up a plan of phased mechanisation and computerisation for the banking industry. The committee had suggested that over the next three years bank branches should attain mechanisation. However, banks did not have a suitable organisational set-up or technically qualified staff to implement it. Paucity of space in congested metropolitan branches, inadequate power supply, unavailability of application software that would suit the needs of individual banks were other stumbling blocks. But the biggest stumbling block to automation has been the bank unions. In an agreement signed in 1987, they set a limit of 3700 branches for computerisation, by September that year, with an addition of another 2200 branches in the next two years⁴. Computerisation was to be limited only to the urban and metropolitan branches of the banks, and the regional and zonal offices.

In fact, another agreement between the IBA and the All India Bank employees association signed in march 1987 details the installation of ALPMs- which were not treated as computers but just electronic accounting machines with memory⁵. The agreement outlined the installation of electronic ledger posting accounting machines and mini computers⁶. These machines would cover functional areas like current accounts, savings bank accounts, deposit, cash credit loan and general ledger accounts. It was also agreed that staff would not be retrenched. Today the issue has turned into a number game with bankers trotting out meaningless statistics like the numbers of ELPs in operation ,accounts, services etc. In reality only about 40 of the 43000 branches of all nationalised banks are fully computerised⁷.

It was only last October that a memorandum of settlement between the unions and the IBA finally enabled banks to go ahead with computerisation. Though the memorandum lays down the broad limit (only those branches which process an average of 750 vouchers daily may partly or fully computerise their operations), bankers feel the agreement does not hamper their plans⁸.

The negative outcome of every new agreement on mechanisation and computerisation is that the old one is totally shelved and the cost involved is not talked about.

The 1987 settlement allowed for ALPMs with configurations not exceeding 256 Kilobytes and 16 bits⁹. The new settlement allows full computerisation of those branches where ALPMs are already installed even though the minimum voucher load is less than 750 voucher¹⁰. So the old system will have to be scrapped.

But bankers are philosophical about the cost. J. V Shetty, Chairman and Managing director, Canara Bank and R Viswanathan, Deputy Managing Director, SBI, feel the costs should be weighed against the benefits¹¹. Shetty feels computerisation will improve service to the customers and enhance both productivity and profitability. So banks should not worry about funding¹². "More over, the computerisation cost is treated as capital expenditure and not revenue expenditure" he adds¹³.

The accent now is on meeting customer demands. As one Bank Executive puts it "Computerisation should not be a mere translation of a manual procedure. It should lay greater emphasis on customer needs"¹⁴. This would include a single point

entry, full security and re-usability of data, in short a very up-to-date management information system. According to a senior banker, "to computerise one's operations, the basic information has to be complete. This is where the Indian banking industry is lacking"¹⁵.

However, there is confusion about what constitutes full computerisation. According to the IBA, a bank is fully Computerised if all functions like term deposits, loans and advances, credit / over drafts, inward / outward bills, remittances, are covered¹⁶. But some bankers feel full computerisation involves an integration of all the functions and a single machine to give access to any information in an integrated manner, as in a local area network (LAN) linking both inter branches and intra branch function¹⁷.

Telebanking is another facility offered by partially and fully automated branches. Through the 24-hour telebanking facility, the account holder can enquire into the balance in his account, ask for details of the last five transactions, register requests for cheque books or statements of account.

Whether or not to invest in advance technology is no longer a question for banks in India. In the current banking environment marked by restructuring of the banking industry, increased market competition and rising customer expectations, the banks have perhaps no option.

In today's competitive world, the financial service industry in India is now facing tremendous competition from foreign banks, other private banks and financial institutions who appeared in the arena equipped with improved information technology. It is

no more a sellers market¹⁸. The commercial banks would not be able to improve their performance and compete with foreign banks as also new entrants in the private sector unless their operations are adequately mechanised. To cope with the problem inherent to improving the customer service, house keeping and to procure higher magnitude of business volume, introduction of total branch mechanisation is considered to be a right approach.

Computerisation of banking operations has assumed added urgency in the context of the Govt.'s policy of liberalisation and in view of the financial sector reform. Performance improvement is essentially a function of generating more business, streamlining internal management and up grading customer service. In all these cases, the Indian banks by not using computers have lost a substantial amount of business to foreign banks.

Though the process of computerisation in Indian banks commenced more than a decade ago, it has not really caught up so far. As is well known, Rangarajan committee on mechanisation in banking industry had recommended that banks should introduce computerisation/mechanisation at branch regional, zonal and head office levels in a phased manner. Based on these recommendations though action plans for computerisation in public sector banks were drawn up, the progress made in this regard does not appear to have come up to the desired level except in a few banks like SBI .

Even the Narasimham committee endorses the view of the Rangarajan committee that there is urgent need for a far greater use of computerised system than at

present. According to the committee, computerisation has to be recognised as an indispensable tool for improvement in customer service, the institution and operation of better control systems, greater efficiency information technology and the betterment of the work environment for employees¹⁹. These are essential requirements for banks to function effectively and profitably in the increasingly complex and competitive environment which is fast developing in the financial service segment of the economy.

One reason for the lack of progress in this direction is the resistance from the employees unions on the apprehension that this may result in wide spread unemployment in the banking industry. In the committee's view it would be taking a simplistic view to perceive mechanisation and computerisation as substituting labour²⁰. In respect of repetitive operating it could perhaps be argued that mechanisation could substitute labour but there are limits to which even this can go. As mentioned earlier, if customer service is to be improved, especially at the metropolitan centres, even in respect of fairly routine banking transactions, such as servicing the depositor, a measure of mechanisation and computerisation may be necessary²¹. In any event modern banking involves a great deal of processing of masses of information. Timely and adequate information about various aspects of the business have become important for an efficient management information system. Thus the increasing use of electronic aids for cheque clearance and transmission of funds is something which cannot be done by employing more hands²².

Therefore in the committee's view, Computerisation should not be regarded as a substitute for labour but in fact as an aid to handling a large volume of business and, in that sense leading to large employment opportunities²³. In the services

sector, machines and computer bring about a qualitative change in the nature of service and where time is an essential input in the quality of service, labour and machines cease to be substitutes but assume complementary roles. As pointed out by the Rangarajan committee, the programme of computerisation envisaged would not result in any reduction of labour but some reallocation of work and the objective of mechanisation is not to replace man with machines but reduce the drudgery involved in routine work²⁴. There has to be a recognition on the part of bank managements and labour that the system cannot hope to be competitive internally and keep in step with the wide ranging innovation taking place in the banking industry abroad without a radical change in work technology and culture. The management of banks also do not appear to have exerted themselves sufficiently in furthering the process of computerisation and have taken shelter behind the perceived opposition of organised labour²⁵. The bank managements in India have to gear up and devise suitable institutional responses to the challenge of emerging competition.

To provide efficient customer service, there is really no escape from mechanisation and computerisation. It is therefore heartening to note that the recently concluded agreement between the IBA (Indian Banks association) and representatives of various unions of bank employees takes note of the imperative need of computerising commercial banks operations in a phased manner. The proposal had been hanging for quite some time, though some limited advance had been made in this direction through the introduction of about 300 mini computers and about 6000 all purpose ledger machines²⁶.

The agreement paves the way for computerisation of 2500 to 3000 bank branches in metropolitan and other urban centres²⁷. Although the All India Bank

Employees Association the largest bank union had agreed to the computerisation programme a few months ago, some relatively smaller unions had been dragging their feet. It is gratifying that a mere broad based agreement has now been reached on the issue, even though linked to the employees pension demand. Dr. Rangarajan said "with the new agreement signed with the trade unions, the ball is in the court of the banks to usher in an era of information and technology in this service industry"²⁸.

In this context, it may be interesting to know what type of "leap forward" has been achieved by banks in developed countries in the matter of automation and computerisation. A recent survey of international banking scenario has highlighted what is happening to banks abroad and how they are making increasing use of latest information and computer technology to cope with several threats, pressures and competition. Some of the latest technologies being currently used include automatic teller machines not only for dispensing cash but also for financial products such as home-equity loans and credit cards, tellers linked to central customer records and a link between credit customer records and link between credit cards and customer loans²⁹.

Bank tellers can now verify customer signature with a fax machine. A significant use that a computer is being put to is in the area of reporting functions with a wide variety of applications. It can enable bankers to link general ledger and other accounting data into accurate and comprehensive dimension of their operations. The banks can use this data inter alia, to measure the true bottom line profitability of any business unit, product or customer segment within the organisation. The latest addition to this plethora of mechanical aids is a machine which counts currency notes in one high-speed pass. A coin sorter can reach a top speed of 3000 coins per minute³⁰.

These mind-boggling innovations do highlight the extent to which the various banking operations are facilitated with the new technology. The bankers, can choose from dozens of high tech banking aid to suit their own operations. But in the current banking environment in India when the profitability of the banks is under severe strain it is just as important to contain costs, as it is to accelerate mechanisation. The bankers would, therefore have to be quite circumspect in the matter of choosing various computer applications and processes.

The various advantages of computerising a bank are given below.³¹

Benefits to the clients

1. Single window service.
2. Quality customer service.
3. Passbook updated immediately.
4. Withdrawal of cash almost instantaneously.
5. Round the clock access through remote terminal.

Benefits to the bank/management.

1. Increased profitability.
2. Safeguard and security against fraud and forgery.
3. Back up of records.
4. Effective automation of the branch.
5. Handle more business in the same premises.
6. Raising productivity of staff and effective utilisation of manpower.

7. Crisis management.
8. Connecting of branches with head office/controlling office.
9. Facility to know the balance sheet and profit and loss statement at a quick frequency.
10. Control returns and RBI reports submitted in time.
11. User-friendly with menu driven facility to ensure smooth operation.

Benefits to Employees.

1. Eliminating drudgery of repetitiveness.
2. Faster information retrieval.
3. Complete satisfaction of employees and congenial work environment.

NOTES

1. Bandyopadhyay, "Mechanisation and Computerisation", Emerging Challenges in Indian Banking and policy implications, (1987), P 43.
2. Ibid.
3. Ibid.
4. Manali Reshamwala, "Survival of the automated", Economic Times (Bombay), Mar 24, 1994.
5. Ibid.
6. Ibid.
7. Ibid.
8. Ibid.
9. Ibid.
10. Ibid.
11. Ibid.
12. Ibid.

13. Ibid.
14. Ibid.
15. Ibid.
16. Ibid.
17. Ibid.
18. G.Umesh Shenoy, "Total Branch Automation", IBA Bulletin, P 118, Jan 1994.
19. Report of The Committee On The Financial System, (M Narsimham, Chairman), Nov 1991, P 89 - 90.
20. Ibid.
21. Ibid.
22. Ibid.
23. Ibid.
24. Ibid.
25. Ibid.
26. "A Significant Bank Accord", The Business & Political Observer, Nov 2, 1993.
27. Ibid.
28. "Computerised banking to begin soon", The Business & Political Observer, Nov 5, 1993.
29. R.G. Bhatnagar, "Hitech in Indian banking", Financial Express (Bombay), Feb 10, 1994.
30. Ibid.
31. Supra, n. 18.

CUSTOMER SERVICE

Historically the banking industry's systems have been manual and geared to meet the bank's security, information and reconciliation need¹. Thus, as long as these basic needs were met, there was no impetus to change existing systems to make them more customer-friendly. This despite the fact that due to massive branch expansion particularly after the nationalisation of banks in 1969, which took banking virtually from the elite to the masses, there was steep decline in the quality of customer services. A possible reason for this could be that till about a decade ago there was no major competition for the nationalised banks.

The pressure on manual systems started becoming unbearable from the mid sixties and peaked in early eighties². Around this time frauds surfaced in many banks, housekeeping had taken a back seat; inter-branch reconciliation was in disarray and customer dissatisfaction was at its peak. The Government of India appointed a working group under the chairmanship of Shri R. K Talwar to study the problems of customer service in Banks in 1975 likewise, another committee was constituted in September 1990, by the RBI and chaired by M. N Goiporia. The report which was released in December 1991, contained a detailed study of the present status of customer service in public sector banks and recommendations for improvements.

Among the Gopoiria committee's major recommendations are³ :

1. To ensure service to customers begins exactly at the commencement of business hours, the working hours of the bank staff should commence 15 minutes before business hours begin.

2. Business hours - except for cash transactions should be extended till one hour before the bank closes.
3. Small cash payments should be made to individual account holders, even after business hours.
4. To ensure uninterrupted service, no counter should remain unattended during business hours.
5. The letter system should be introduced at all Area 1 centres - including state capitals - at one or more branches.
6. Passbooks must be updated immediately on submission. This service must be computerised and customers need to be educated about the need to get passbooks updated regularly. The committee found that customers complaints in this area have remained unabated.
7. Banks should send an intimation of the impending maturity date for term deposits, in advance. In cases of premature withdrawal, a penalty should be charged only on those units that are withdrawn. This should not affect the interest being earned on other subsisting deposit units. Further, when any changes are made in the interest rate structure, the changes should be made applicable to existing deposit holders as well.
8. The facility of instant credit for outstation cheques should be raised to Rs. 5000 . This would help a large number of customers if implemented widely. At present customers have to wait a long while to get credit for small amounts.
9. Loan proposals should be simultaneously submitted by the bank branches to all the controlling offices and, if required, the processing official from the controlling office should visit the branches so that the processing can be expedited.

10. A single window concept should be introduced for issuing drafts to save the customers time.

Some of the recommendations made by the committee were implemented⁴. These include :

1. Customers who are in the banking hall prior to the close of business hours are now attended to in most bank branches.
2. In urban residential areas many branches work on Sundays and take their off on the day when the local market is closed.
3. Time norms for a number of services are displayed in most of the branches, though their implementation is quite a different story.
4. Marked improvement has been seen in cash transactions wherever the teller system has been introduced, which is mostly in the big branches.

However, many of the committee's major recommendations are yet to be implemented. Most people continue to perceive bank employees attitude towards customers as negative. The sophisticated services available at the branches of foreign banks have raised customer expectations particularly in the urban areas.

From time to time the RBI has been issuing instructions to banks to implement the recommendations selected by them from the committee's reports. But the implementation has been half-hearted and the public continue to be dissatisfied with the kind of service available at the bank counters. This is largely because of the high degree of indiscipline prevailing amongst the bank employees and the total lack of courage on the

part of the bank management to enforce disciplinary action against those who deny service or give dis-service.

Now the RBI has released further instructions on the Goiporia committee report on customer service on the following issues⁵.

I. Extension of business hours upto an hour before the closing of working hours, for non - cash transactions.

The non - cash transactions include:

- a) Non voucher generating transactions and
- b) Voucher generating transactions.

The non - voucher generating transactions include:

- 1) Issue of passbooks/statements of accounts
- 2) Issue of cheque books
- 3) Delivery of term deposit receipts/drafts
- 4) Acceptance of share application forms
- 5) Acceptance of clearing cheques and
- 6) Acceptance of bills for collection.

Voucher generating transactions are :

- 1) Issue of term deposit receipts
- 2) Acceptance of cheques for locker rent due
- 3) Issue of traveller's cheques
- 4) Issue of gift cheques and
- 5) Acceptance of individual cheques for transfer credit.

Banks have been advised to notify such non-cash transactions to the customers so that they can take advantage of the service during the extended hour.

II. Fixing of the working hours of staff 15 minutes before the business hours.

This has been necessitated because of the habitual delay in attending to the offices by the bank staff in most of the branches. New banks have been advised to make necessary arrangements in metropolitan and urban centres, where such an arrangement does not already exist, to commence 15 minutes before the start of business hour after taking into accounts the provisions of the local Shops and Establishments Act. But, the fact remains that most of the managers do not even have the courage to take disciplinary action even if an attender comes late to the office. Bank unions are powerfully militant that they successfully circumvent implementation of discipline in the banks to gain the support from the member, so most of the Reserve Bank of India instructions are on paper only.

III. Introduction of bank orders in various denominations.

This is a good advice to the banks to introduce pre-denominated bank orders in denominations not exceeding Rs 5, Rs 20, Rs 500, Rs 1000 or such other denomination not exceeding Rs 1000 as they may consider appropriate similar to traveller's cheques.

IV. Acceptance of small denomination notes.

Directions under this head has been necessitated due to the out right refusal to accept small notes from customers and also from non-customers for issue of drafts.

V. Exchange of mutilated and soiled notes.

The RBI Claims that its note refund rules are sufficiently liberal and the extent of rejections is negligible.

VI. Communication to various offices regarding changes in rates of interest.

It has been also said by the RBI that the individual banks should take the responsibility to see to it that the changes percolate fast to all their branches so that the customers come to know of the changes quickly.

Piece-meal instructions as above based on the Goiporia committee report, which has given 97 recommendations are coming now and then from the RBI. Unless the RBI monitors its instruments to improve customer service with punitive action for non-compliance and so long as the bank staff do not mend their ways, the instructions will only be on paper and the customers will continue to suffer yearning for qualitative service from banks.

In a competitive service industry like banking, customer service is simply, the bottom line⁶. During two decades following nationalisation, the banking network in the country, expanded at geometrical rate whereas infrastructure, including control mechanism and trained personnel increased at arithmetical pace. This continued lopsided development of banking network, without corresponding strengthening of infrastructure resulted in three main causations for deterioration of customer service viz ever increasing volume of work, multifarious activities of banks and unsatisfied expectations of customers⁷.

During the last couple of years or so customer service, in the fast

changing scenario of economic liberalisation, has assumed different connotations. Emergent facets of customer service can now broadly, be distinguished as counter orientation, redefined social banking and integrated assistance to corporate borrowers⁸. Customer service can no longer be perceived as fulfillment of elementary banking needs, catering to walk-in business. Now customer service has to be understood as a product carrying the individual banks corporate image in the market of modern banking.

For a majority of the customers, counter is effectively the face of the bank. They do all their banking transactions at one counter or another, without having to travel beyond it. Technological upgradation, which ensures backward integration of different banking facilities through cross linkage can provide single window dispensation of different day to day banking service. Keeping in mind the different categories of branches, their clientele and cost factor technological upgradation will have to be need based and in the identified thrust areas. Branches at rural and semi-urban centres obviously do not offer much scope for sophistication. At other centres, particularly at metro centres, technological upgradation will have to receive top priority. Also in the area of foreign business dealings, involving banks abroad, Indian banks will have to gear up to render services matching international standards. ATMs, modem connections, specialised branches etc are some of the steps the banks have taken or will have to take to meet the aspiration of the customers⁹.

Under twin influence of economic liberalisation and spread of urbanisation the face of priority sector lending will alter radically. This will offer large scope to the banks to go in for specialised services such as ready credit rolling for cash crop cultivation, technical know-how through their trained personnel for non-traditional

and allied activities like sericulture, aqua culture, floritrade etc.¹⁰

Illustratively our country produces 27 million tonnes of fruits and vegetables annually of which hardly 1% is processed, whereas other developing countries like Brazil, Philippines and Malaysia process 70%, 78% and 83% respectively, of such produce¹¹. Global floritrade is estimated to be around Rs 70000 crores wherein presence of our country is virtually nil¹². These statistical data amply highlight tremendous scope for the above mentioned specialised services at these centres.

In the context of present day strain on profitability the single most crucial factor for the bank for rendering innovative services will be pricing such services. Days of subsidised services are clearly over. The entire gamut of different services of the banks will have to be cost benefit effective. In fact, with reduction in average spread, both conventional and unconventional, the bank will have to recognise services, as a source of income and price them accordingly. Scope of services of the bank will essentially be determined by pricing them so as to make them cost benefit effective for both, the bank and customers.

The banks will be in a positions to meet challenges of rendering efficient service in modern banking environment only if vital infrastructure in the form of trained and motivated human resources, is developed. For this purpose, the banks will have to identify specific key service areas, define job role, train or recruit suitable personnel and establish responsive machinery aimed at not just customer service but customer satisfaction.

The greatest strength of Nationalised banks is their vast country wide network. This strength is derived from the growth and economic development of inner areas and pockets in the country. In order to meet challenges of foreign banks and emerging private sector banks, the nationalised banks will have to draw on this strength of vast branch network by turning them into service units. Towards this goal, they will have to go in for conscientious consolidation of identified branches in terms of specific need based services which they can render to a target group¹³. Illustratively, specialised SSI and NRI branches in the relevant interior areas of Punjab and backwaters of Kerala can respond to needs and potentials of these pockets through tailor-made services¹⁴. In order to enable them to render better customer services in liberalised and competitive economy nationalised banks will have to function with higher volume and lower margin which will not be possible without greater per head productivity, effective technological stride and constant stress on profitability including reduction in Establishment cost.

Challenges of modern banking in the country has emanated with the accelerated advent of foreign and Private sector banks following liberalisation. With their technology and freedom in recruitment of personnel they are all set to take away further share of the cream of business. Unless nationalised banks change their thinking process and commit themselves to service oriented work culture, they will be hard put to stay in the competition in modern banking.

NOTES

1. P.G. Kakodar, "Systems and Procedures", IBA Bulletin, P 68, Jan 1994.
2. Ibid.
3. V.N. Kapur, "Who cares for clean-ups? Not banks", Economic Times (Bombay), March 20, 1994.

4. Ibid.
5. B. Ramachandra Rao, "Need to improve customer service by banks", Deccan Chronical (Hyd), Aug 30, 1993.
6. P.R.Merchant, "Customers Service", IBA Bulletin, P 76, Jan 1994.
7. Ibid.
8. Ibid.
9. Ibid.
10. Id at P 77.
11. Ibid.
12. Ibid.
13. Id at P 78.
14. Ibid.

CLOSURE OF UNVIABLE BANK BRANCHES

The government of India nationalised the major commercial banks in 1969 with the following objectives¹.

1. To open more rural branches to strengthen the infrastructure for rural savings.
2. To tap rural savings to facilitate capital formation.
3. To satisfy the legitimate aspirations of those sections of society hitherto not covered by institutional finance.

Nationalisation is a success in the sense that majority of the bank branches are operating in rural areas. In other words 57% of the total bank branches are rural branches².

Non-viability of these rural branches is a disturbing feature now. The reasons identified for the non-viability of rural branches are³

1. Location - Most of them are located in remote areas where access is difficult.
2. Economic unviability- caused by a dearth of any profit making activity in the area.
3. Lack of involvement on the part of rural bankers.

Dr. Abrar Ahmed, Minister of State for Finance, said according to RBI as on 12 December 92, 9336 branches of Public sector banks including those of the state bank of India had not made profits⁴. The RBI was considering proposals for closing down loss making branches in urban, metropolitan and rural centres which were also served by existing profit making banks. Apart from closing down branches the RBI had issued instructions allowing banks to swap their loss making branches with other

banks. A list of unviable branches of banks named were:SBI with 2511 loss making units, State Bank of Bikaner and Jaipur (107), State Bank of Hyderabad (45), State bank of Indore(56), State Bank of Mysore(147),State Bank of Patiala(29) State Bank of Travancore (38) Allahabad Bank(159), Andhra bank (102), Bank of Baroda (418), Bank of India (276), Bank of Maharashtra (587), Canara Bank (99), Central Bank of India (833), Corporation Bank (106), Dena Bank (92), Indian Bank (171), Indian Overseas Bank (309), New Bank of India (109), Oriental Bank of Commerce (47), Punjab National Bank (559), Punjab & Sind Bank(116), Syndicate Bank (939), Union Bank of India (286), UCO Bank (739), United Bank of India (304), and Vijaya Bank (130)⁵.(The break up of unviable branches is given in Table 1).

The outright closure of a branch by an individual bank is indeed a sensitive issue as it is associated with the very image of the bank and public confidence in it. Customer inconvenience, problem of staff mobility, loss of public confidence may also result in flight of business from the concerned bank.

The closure move may not be acceptable to many on the following grounds⁶.

1. Closure move is totally against one of the objectives of nationalisation.
2. Deprives the institutional financial support already extended to the poorest of the poor.
3. Allows the unorganised sector of Indian money market consisting of money lenders and indigenous bankers to dominate still further in rural credit.
4. Withdrawal of institutional infrastructure may make the rural poor to divert their savings towards quack investments.

TABLE 1

UNVIABLE BANK BRANCHES AS ON MARCH 31, 1993

Banks	Rural		Semiurban		Urban		Metropolitan	
	1991-92	92-93	91-92	92-93	91-92	92-93	91-92	92-93
SBI	4350	4378	2235	2239	1216	1287	781	787
BANK OF BARODA	1192	1203	395	416	423	432	306	309
BANK OF INDIA	1293	1295	387	389	362	380	281	290
PNB	1709	1723	501	504	524	539	320	325
CANARA BANK	781	781	527	538	385	394	332	334
CENTRAL BANK OF INDIA	1497	1512	667	668	506	526	337	336
INDIAN BANK	542	545	342	344	269	273	210	210
UBI	917	918	369	374	331	344	228	231
ALLAHBAD BANK	1010	1010	299	299	298	298	196	196
DENA BANK	513	514	192	193	192	201	206	109

Source: Financial Express (Bombay), Mar 30, 1994.

5. The efforts so far taken by these rural branches for the creation of awareness about integrated rural development may be lost in the absence of institutional support and
6. The momentum gained by the non-governmental agencies in the sustainable rural development may get disturbed owing to lack of financial and technical support from the rural bank branches.

The above points do not argue that unviable bank branches have to function at any cost. No doubt in a developing country like India, banks have to undertake social responsibilities but not at the cost of profitability for ever. If rural branches have not turned around even after two decades of their existence, certainly one may doubt their efficiency.

Certain suggestions have been given by R M Chidambaram to make the rural branches viable⁷.

1. Rural branches of banks should have an approach of market orientation.
2. The attitude of Indian rural bankers to confine themselves to bank premises alone should immediately be dispensed with. Indian rural branches have to adopt the Bangladesh model of bare foot banking for real rural banking.
3. Bankers have to recognise the concept of "real India is rural India" and experienced bankers should come forward to serve in rural areas to make rural banking a purposeful one.
4. Dearth for profit-making activities in rural areas is one of the reasons for economic unviability of rural branches. In many cases, branches are merely accepting deposits without any means of profitably deploying them. Rural bankers have to identify right

people and projects for funding. This is possible only by involved bankers through their pragmatic post sanction appraisals.

5. Rural branches are piling up losses as their advances turned out to be consumption rather than production loans. Effective post sanction monitoring alone can remedy such a situation. Dedication, sacrifice of comforts and team spirit are the pre-requisites for post-sanction monitoring.
6. The Indian banking industry is overstaffed and the rural branches are no exception to this. Hence bank managements have to reduce staff strength to the minimum to reduce the cost of establishment in rural branches. Converting the non-viable rural branches into satellite offices as suggested by the RBI is also a welcome move.
7. All chronic loss incurring branches have to be closely monitored. The monitoring measures include providing break-even packages to loss-incurring branches, increasing commission income through proper pricing of services, controlling expenditure, and setting time bound targets for bringing down the level of overdues and improving recoveries.

Banking sector reform has a new innovation. Nationalised banks can now swap loss-making branches⁸. This has followed the introduction of revised norms for income recognition and capital adequacy to bring financial accounting and prudential standards in line with global levels. The indiscriminate spread of branches in the past has adversely affected the profitability of banks. Quite often branches were set up without regard to the specialisation or the institutional knowledge of the particular bank or the banking needs of the customers. For e.g. banks which specialised in overseas banking found that they were lending to local small scale industrial units; others might have been better at industrial finance but found themselves involved in agro-lending. Political expediency

often determined the location of bank branches forcing nationalised banks into regions they knew nothing of. In many cases a lack of grass-root awareness on the part of the personnel staffing the branches has made it easier for borrowers to flout the loan conditionalities, if not avoid repayment altogether. Mismatches between a bank's expertise and institutional knowledge and its customer requirements led to poor service as well as large losses.

Swapping is a good solution for branches that could be potentially profitable. This is the case when the losses are the result of mismatches in bank services and customer requirements. Swapping is a sensible procedure only if there are differences in knowledge and information across banks. Swapping branches will help banks to consolidate their positions. They could focus on customers that could be served according to the area of expertise of the bank. Locational consolidation could also take place as banks could concentrate their branches in regions, where their knowledge of local institutions is most comprehensive.

But this may not be enough, so closure of unviable branches is inevitable. An exit policy is a key component of the strategy for the future. There has to be an exit policy rather than mergers of the kind that are taking place. Clearly the reform of the financial sector cannot be limited to cuts in SLR and concessional lending but efforts have to be made to slim down the banks. In fact, the entire strategy pursued all these years has to be reversed. While in the fifties, sixties and seventies it was necessary for the government to apply itself seriously to spreading the banking habit, since the eighties it had become much less urgent and policy makers had to observe a measure of selectivity. Nationalisation was also prompted by the fact that banks then were not only urban, but also private industry and trade oriented. The growing public sector needed

strong bank support and the government also had to see to it that poverty alleviation programmes were not left high and dry by the banks. But for nationalisation the government's socio-economic goals would have remained pipe dreams. However in the eighties, though the govt. thought it fit to nationalise 6 other banks at the start of the decade, the social focus of banks was overdone. While it would be far-fetched to see in the 1992 securities scandal the impact of this phenomenon, it certainly reflected the strains and stresses of long years of sustained social banking.

Now, with the economy overall being turned upside down, the policies pushed vigorously in the past have to be ditched and a fresh approach formulated. Yet, with all this talk about liberalisation, the reformists refuse to look at the option of closing down those constituents of the banking sector that are in the red. Prudential norms and capital adequacy get reduced to silly notions when the banks that are accumulating losses are still around. Though generally one can expect rural and semi-urban branches to be closed down the break-even principle should be applied to others as well.

However winding up branches especially rural ones is not easy. Before the RBI grants approval the district level committees have to clear the proposal. This is fraught with consequences as local politicians have a say in the matter. The second level of authority, the state government has to agree, the RBI's okay is sought at the final stage. Finally there are the trade unions to contend with who are up in arms to thwart any move to close down unviable branches.

The RBI has directed the Calcutta based United Commercial Bank, United Bank of India and the Bombay based Central Bank of India to close down

50,25 and 10 loss making branches respectively by March 31, 1994⁹. While the UCO Bank has registered a staggering Rs 444 crores loss the UBI's losses total Rs 279 crores during 92-93¹⁰. The Central Bank expects a gross profit of Rs 1.34 crores in 1993-94 despite suffering an operational loss of Rs 38.93 in the first half of the current fiscal year¹¹. The RBI has also directed UCO authorities to wind up one of the two UCO branches in Hongkong and the Leicester branch in the UK and explore the possibilities of selling the debts to some other banks like SBI¹². The closure of the branches is part of the RBI conditionalities of the Memorandum of Understanding which the UCO and UBI will have to fulfill to get a fresh capital infusion of Rs 535 crores and Rs 215 crores respectively¹³. Meanwhile the Indian Overseas bank has embarked on the task of pulling down the shutters of around 100 loss incurring branches by the close of the current financial year. The reason for pressing on with the decision has been a loss of Rs 753.74 crores the IOB suffered during 92-93, the highest among Public sector banks¹⁴. In the case of IOB, a majority of the branches that will be closed down belong to the erstwhile Bank of Tamil Nadu which was taken over by IOB in 1990.

Under the provisions of the Memorandum of Understanding neither of these banks can open a branch unless it satisfies the RBI about the viability of the branch in the first year itself. The RBI has been particularly harsh towards UCO and UBI as it instructed both of them to drastically slice off the number of their zonal offices as part of the measure to offset the loss. UCO has agreed to close down 8 urban, 13 semi-urban and 29 metropolitan branches¹⁵. Ruling out retrenchment of employees the UCO Bank chief said that surplus staff would be regrouped and re-deployed either in other branches or in teams for loan recovery, market promotion, house-keeping and other vital activities¹⁶. In a reversal of roles, the trade unions of UCO bank have volunteered to help the

management in identifying the loss-making branches to be closed down.

The union finance ministry is also keeping its options open on merging quite a few banks in the coming days. While the Narasimham committee had suggested restructuring of banks through the merger route, it had, at the same time, cautioned that any such move should be market driven and based on profitability considerations¹⁷. Further, it added that mergers should be done only with the understanding and support of bank staff to avoid the problems associated with a topdown approach¹⁸. Banking circles point out that if the rationale of the Narasimham Committee is accepted as the basis for a merger then the New Bank of India and the Punjab National Bank merger has failed on all three counts¹⁹. A study of the results of 20 nationalised banks for the last financial year reveals that mergers are unlikely to be a viable option for any of these banks²⁰. The quantum of losses of the 13 loss making banks far exceeds the total profit recorded by the remaining seven banks and with the possible exception of Canara Bank whose net position is satisfactory none of the other banks would be in a position to absorb losses of this magnitude.

The RBI has also put a recruitment ban on all the loss making nationalised banks till they come out of the red. However there is no ban on recruitment for the healthy banks. Till date all the nationalised banks had the freedom to appoint, based on requirements, 0.75% to 1.5% of their total staff strength each year²¹. However, they will be allowed to recruit only on compassionate grounds.

Apart from the ban, the RBI has also instructed the loss making banks to "restructure" their entire work force and to bring down the present four tiers of

operation to three tiers²². The four tiers include branches, regional offices, zonal offices and the head office. The RBI wants the banks to close down regional offices and redeploy the work force in other areas.

The three tier operation concept had earlier been recommended by the Narasimham Committee but the difference between that and the RBI directive is that the Committee had recommended abolition of zonal offices and not regional offices. Senior bank officials observed that abolishing zonal offices would have been a more prudential approach as regional offices are closer to the grass root level²³.

Since closures appear to be the only viable solution available to the banks, they need to undertake a critical analysis of the operations of their branches and consideration needs to be given to selective closure of a few branches which are totally unviable. Such selective closure is unlikely to affect the needs of customers as in most cases other strong banks will have branches in the proximity of the branches of weak banks. Only this will carry the reforms initiated so ambitiously in the area of banking to its logical conclusion.

NOTES

1. R.N. Chidambaram, "Uncertainty looms over rural branches", Financial Express (Bombay), March 30, 1994.
2. Ibid.
3. S.C. Dhali, "Closure of bank branches not so easy", Financial Wizard Weekly (Bombay), Feb 12, 1994.
4. "RBI allows banks to swap branches", Financial Express (Bombay), Dec 7, 1993.
5. Ibid.
6. Supra, n. 1.

7. Ibid.
8. "Good idea", The Economic Times (Bombay), Dec 8, 1993.
9. "RBI orders 85 bank branches closed", Deccan Herald (Bangalore) Dec 10, 1993.
10. Ibid.
11. Ibid.
12. Ibid
13. Ibid.
14. Ibid.
15. Ibid.
16. "UCO bank to merge 50 loss making branches", The Business and Political Observer, Dec 6, 1993.
17. K.V.Rao, "Can mergers cure bank's illness?", Free Press Journal (Bombay), Jan 17, 1994.
18. Ibid.
19. Ibid.
20. Ibid.
21. "Recruitment bank on losing banks", Telegraph (Calcutta), Nov 24, 1993.
22. Ibid.
23. Ibid.

CAPITAL ADEQUACY

The Basle Committee on Banking Regulations and Supervisory practices set up by the Banks of International Settlements under the Chairmanship of Mr. Peter Cooke had prescribed in 1988 that the capital of the banks should have at least a minimum of 8% of the risk weighted assets. Capital Adequacy is the measure of a bank's internal strength to provide for losses that may arise upon its advances going bad, which bankers term 'Credit Risk'.¹ It is expressed as a proportion of capital to assets weighted according to the risk of default attached to them. Other things remaining equal, the greater the capital relative to a bank's risk weighted assets, the better insured is the bank against credit risk. The Committee settled for an 8% capital adequacy norm, which meant that for every Rs. 100/- of loans extended by it the bank should have Rs. 8/- of capital on its balance sheet. These risk weights vary from zero % for government securities to 100% for loans to business units. Stated otherwise, if for e.g., a bank invests all its funds in government securities it need not expand its capital base since the risk weight in that investment is zero. But, on the other hand, if the bank decides to increase its lendings, its risk also increases and therefore it has to widen its capital base so as to be in a position to absorb future shocks.

To provide for such exigencies, the G-10 countries have adopted a frame work for measuring capital adequacy norms and the minimum standard to be achieved in their respective countries. The Reserve Bank of India has also by and large accepted these recommendations of the Basle Committee as proposed by the Narasimham Committee. The Narasimham Committee had also suggested that bank's in India should gradually move towards the Basle Committee. According to the Advocates

of capital adequacy norm, the ratio of capital funds to deposits or assets is a well recognised measure of the strength and stability of a bank. But before the norms for capital adequacy are complied with, it is necessary to have their assets revalued on a more realistic basis and on the basis of their realisable value.² But while the Reserve Bank of India embraced this norm, it realised that Indian banks were in no position to hit the 8% target overnight. So it asked banks to phase out their plans to attain capital adequacy. All National banks were asked to attain a Capital adequacy of 4% by March 1993. Banks with International operations were supposed to reach 8% by March this year while those whose operations are limited to the shores of the country were instructed to reach the figure by March 1996.³ However at present many banks are not in a position to expand their capital base as required.

All banks operating in India, Public, Private or Foreign have a weak Capital base. This is mainly due to non-revision of minimum capital levels prescribed in the Banking Regulation Act 1949. Added to that, the erosion in the assets on account of loan losses and failure of banks to cover the same fully have resulted in a substantial erosion of the capital funds, though until 1991-92 it did not appear on the face of the balance sheet. However with adoption of the new accounting norms, the erosion in net profit as also the capital base is quite apparent. The combined effect is that many banks have failed to achieve the specified minimum capital adequacy for March 1993. Take the case of Central Bank. It had capital funds of Rs. 258.51 crores as on 1st April 1992. However during 1992-93 it reported a loss of Rs. 383.31 crores wiping out the entire capital funds. The bank however, revalued its assets by Rs. 357.53 crores and showed positive funds of Rs. 133.98 crores. This yields a CAR of just 1.67% against the required 4%.⁴

CAPITAL ADEQUACY RATIO

The RBJ guidelines on Capital Adequacy Ratio are as follow

Capital Funds

A bank's capital funds are divided into two categories.

Tier I

Capital includes paid - up capital, statutory reserves and other disclosed free reserves, if any. Equity investments in subsidiaries, intangible assets and losses should be reduced from Tier I capital.

Tier II

Capital includes undisclosed reserves and cumulative perpetual preference shares, discounted (@ 25%) value of revaluation reserves, general provision and loss reserves (maximum 1.25% of weighted risk assets), hybrid debt capital instruments (maximum 50% of Tier I capital).

The total Tier-II capital should not exceed the Tier-I capital.

Weighted Risk Assets

Type of Asset Weight (%)

Funded Risk Assets

CRR, SLR, government-guaranteed assets, cash, claims on commercial banks and government. 0%

Other fund-based assets 100%

Non-fund based Risk Assets

Assets counter-guaranteed by both central and state governments. 0%

Short term self-liquidating trade-related contingencies 20%

Note issuance facilities and revolving underwriting facilities, credit lines with original maturity of over one year. 50%

Direct credit substitutes eg general guarantees of indebtedness and acceptances, sale & repurchase agreements, general asset purchases etc. 100%

The capital adequacy ratio is worked out as per the following formula :

$$\frac{\text{Total Capital Funds}}{\text{Total Weighted Risk Assets}} \times 100$$

Source : Capital Market Sep. 13-26, 1993.

The capital of all the 20 Nationalised banks at the end of March 1993 totaled Rs. 4,374 crores with reserves totaling Rs. 2,637 crores.⁵ Their owned funds were at Rs. 7011 crores. This is quite low in the context of the whopping cumulative loss of Rs. 3647 crores.⁶ For further details see Table 1. In the case of Central Bank, Indian Overseas Bank and Syndicate Bank, the net losses incurred during 1992-93 have wiped out their capital reserves.⁷ While Andhra Bank, Bank of Maharashtra and Vijaya bank are border line cases with very little excess of owned funds at the end of March 1993 after net losses incurred during the year.⁸

Canara Bank leads with Rs. 1077 crores owned funds (Rs. 208 cr. of capital and Rs. 869 cr. reserves) at the end of March 1993. Bank of Baroda's amounted to Rs. 591 crores (Rs. 330 of capital and Rs. 261 crore reserves). Punjab National Banks amounted to Rs. 549 crore (Rs. 188 cr. of capital and Rs. 361 cr. reserves). Indian Bank's totaled Rs. 479 crore (Rs. 203 cr. of capital and Rs. 276 cr. reserves) Union Bank's totaled Rs. 242 cr. (Rs. 138 cr. of Capital and Rs. 104 cr. reserves). Oriental Bank of Commerce's totaled Rs. 164 crore (Rs. 78 crores of Capital and Rs. 86 crore reserves) and Corporation Bank's totaled Rs. 93. crores (Rs. 67 crore of capital and Rs. 26 crore reserves).⁹

To help the nationalised banks meet their growing capital problems the government in January 1994 released Rs. 5700 crore (For details refer Table 2). While releasing the amount the Finance Minister said "This is the price we have to pay for having long tolerated management practices in the banks and the type of lending which

TABLE 1

Bank Losses March 1993.

BANK (Rs.crores)	Networth	Profit/ (Loss)
Bank of Baroda	991.25	8.23
Bank of India	1303.82	(331.12)
PNB + NBI	1158.21	(37.78)
Canara Bank	1443.57	26.07
Central Bank of India	722.73	(383.31)
Indian Bank	699.48	6.51
UCO Bank	1050.91	(444.18)
Indian Overseas Bank	1116.80	(752.75)
Union bank of India	441.56	11.26
Syndicate Bank	868.61	(670.08)
Allahabad Bank	359.41	(105.89)
United Bank of India	696.39	(279.36)
Oriental Bank	214.00	20.50
Andhra Bank	297.20	(141.09)
Dena Bank	279.33	(90.51)
Bank of Maharashtra	348.25	(196.51)
Punjab & Sind Bank	374.09	(195.19)
Vijaya Bank	208.56	(97.88)
Corporation Bank	138.38	4.12

SOURCE : Business Standard (Calcutta) , Jan 18, 1994.

TABLE 2**Capital infusion to Nationalised Banks
Fund Allocation**

Name of the Bank	All figures in crores
Allahabad Bank	90
Andhra Bank	150
Bank of Baroda	400
Bank of Maharashtra	635
Canara Bank	150
Central Bank of India	385
Corporation Bank	490
Dena Bank	45
Indian Bank	130
Indian Overseas Bank	220
Oriental Bank of Commerce	705
Punjab National Bank	415
Punjab & Sind Bank	180
Union Bank of India	200
Syndicate Bank	680
UCO Bank	535
United Bank of India	215
Vijaya Bank	85

Source: IBA Bulletin, January 1994.

paid inadequate attention to portfolio quality and recoveries".¹⁰

The government is hoping that such an infusion will help the banks break the basle barrier. The capital infusion is in the form of 12 year government bonds which have a 10% coupon rate.¹¹ The interest earned annually will increase their profitability, while the bonds by virtue of these being treated as capital assets will help the banks meet CAR.

In the past there were no strings attached to the assistance given by the government to the nationalised banks. The result was that the additional equity was used only to offset impairment in net worth caused by the losses incurred by the banks. Even where this was not the case, government support did not always lead to the desired improvement in performance and financial strength. The worsening situation has given rise to the need for a Memorandum of Understanding of agreement between the banks and Reserve Bank of India. It was felt that in return for the equity contribution being made by the government, the banks should at least bind themselves to certain minimum levels of performance in key areas like profitability, productivity and efficiency. The agreements recently concluded by the various banks with the Reserve Bank of India focus on efficiency indications such as the interest spread, average yield on advances and investments, average cost of deposits and funds and the percentage of non-performing assets. Business parameters like average growth and advances and average growth of investments are also emphasised. Another area which has been stressed is upgradation of technology. Targets have been fixed in respect of each of the indicators and banks have been told that failure to achieve will attract penalties.

Not surprisingly, the banks which have posted profits for the year 1992-93 such as Corporation Bank (Rs. 4.12 cr.) and Union Bank of India (Rs. 11.26 cr.) have got away with milder conditionalities than their less efficient compatriots like Indian Overseas Bank (with losses of 752.74. Crore) and Syndicate Bank (Rs. 670.08 crore).¹² Though the loss makers have had strict conditions imposed on them, they have also been given the major chunk of the Rs. 5700 crores, which make some wonder whether efficiency is being unnecessarily taxed. However the profit making banks are plying to get more funds. Public sector banks making operating profits are planning to show 100% of outstanding advances below Rs. 25000 as non-performing assets to extract a greater dose of capital infusion.¹³ Punjab National Bank, Canara Bank, Bank of Baroda, Indian Bank, Canara Bank, Bank of Baroda, Indian Bank and a few other are likely to do this even though the Reserve Bank of India has permitted the banks to make provisions to the extent of 5% for bad Advances below Rs. 25,000/-.¹⁴ By making 100% provisioning for small outstandings, they can show a higher amount of losses which will in turn help them attract higher doses of funds in the second round of capital infusion.

The government has also approved the proposal to amend the Banking Companies (Acquisitions and Transfer of Undertakings) Acts 1970 and 1980 to enable nationalised banks to raise equity from the capital market.¹⁵ The government is increasing the authorised capital of nationalised banks to a maximum of Rs. 3,000 crore per bank.¹⁶ The minimum equity capital of each bank will be Rs. 1500 crores which is split as 150 crores fully paid up equity shares of Rs. 10/- each.¹⁷ The changes are part of a package to change the equity structure of the nationalised banks, proposed in the Banking Companies (Acquisition and Transfer of undertakings). Amendment Bill,

1993. According to the proposed changes, the central government may after consultation with the Reserve Bank of India and by notification in the official gazette, increase or reduce the authorised capital of each bank subject to a maximum of Rs. 3000 crores and a minimum of Rs. 1500 crores.¹⁸ According to the Bill, the board of the nationalised banks may, after consultation with the Reserve Bank of India and with previous sanction from the government, raise the paid-up capital of the banks by public issue of shares, subject to the condition that the centre would, at all times hold not less than 51% of the paid up capital of the bank.¹⁹ The shares of the banks, not held by the government would be freely transferable.

At present the entire paid up capital of the nationalised banks stands vested in and allotted to the central government. The centre has been contributing to the paid up capital of these banks during the past years. For instance, during the period 1985-86 to 1992-93 the government has contributed Rs. 4000 crores to the paid up capital of the banks.²⁰ According to the government, the resources at its disposal are getting limited, and are also required for other priority areas. The statements and objects of the Bill therefore says that it would no longer be possible for the government to contribute the substantial amounts now required for meeting the prudential norms. Therefore a number of banks are drawing up their own plans to access the capital markets under the new policies to meet their shortfall in capital requirements. While the increased capital mobilised through the capital issues would increase the banks leverage for lending activities, the government would continue as per policy to retain majority ownership. The government is however, aware that merely accessing the markets would not solve the bank's problems. For instance, highly capitalised banks would have a low earnings per share and thereby prove to be unattractive in the capital market.

Several opposition members have opposed the Bill, saying that it was yet another measure aimed at privatisation of the banking industry.

In a significant development, the Reserve Bank of India has recommended to the finance ministry that banks which plan to tap the capital market be allowed to write off capital against losses and debts.²¹ The proposal, if accepted will shrink the government's stake in the banks. According to Reserve Bank of India the move will make bank scrips attractive in the stock market and make fresh capital flotation by banks in the primary market that much easier.²² In the last financial year, a lot of banks suffered. However, the losses were not set off against the net worth. Banks revalued their fixed assets to cushion the losses or carried the loss to the asset side of the balance sheet to be written off from future profits. If the Reserve Bank of India proposal finds favour the losses will first be offset against reserves and surplus, and the residual losses will be adjusted against equity capital. This accounting procedure will make financial statements more transparent. However the shrinking of the equity base will result in a capital adequacy problem. To get over this problem the government is also looking at the possibility of converting equity into debt.

The State Bank of India was the first bank to approach the public to enhance its financial base. The issue which opened on December 15th had 2 objectives: privatisation and fund raising. After the issue, the Reserve Bank of India stake in the State Bank of India will fall from over 98% to under 69%²³. Since the State Bank of India Act already provides for private shareholding, the State Bank of India and its subsidiaries could

go directly in for Public issues. It had planned to raise its equity capital by Rs. 250. crores by issuing 12 crore shares of Rs. 10/- each at a premium of Rs. 50/- per share to the existing shareholders on a rights basis, 1.2 crore shares at the same premium to its employees and 11.8 crore shares of Rs. 10/- each at a premium of Rs. 90/- per share to the public ²⁴. The bank also issued 10 year bonds of Rs. 1,000 each for a total amount of Rs. 500 crores²⁵.

The success of the State Bank of India issue of equity and debt has prompted others to follow suit, especially after the second round of re-capitalisation funds is released by the government by end 1994. Canara Bank is planning to float an equity cum debt Public issue of Rs. 500 crores later this year. ²⁶. Bank of Baroda is also reported to be planning a Rs. 300 crore issue ²⁷. The other banks are Oriental Bank of Commerce, Corporation Bank and Punjab National Bank.

As the deadline to meet the capital adequacy norms approaches, banks have become extremely cautious in advancing new credit. In the first 10 months of 1993-94, bank advance rose marginally by 2.8% as against 12.9% over the corresponding period of 1992-93 ²⁸. This along with the reduction in statutory liquidity ratio has led to an over supply in investible resources for the banks. The other development in the capital market that has led to an increase in the liquidity within the banking system is the funds brought in by the foreign institutional investors in the stock markets. According to official estimates this is around 3,000 crores ²⁹. Since banks have to use at least some of the money profitably, money is piled into gilt edged securities. As these securities are floated by governments. Central Banks believe investing in them is a risk free affair. So any such investment need not be backed by capital on the balance sheet.

In the first 10 months of the current financial year, investments by Indian banks in gilts shot up by 10.9% at a time when SLR had been pared down³⁰. But there are serious problems with this. What banks are doing is using short term funds which are raised through deposits to invest in securities with maturities of upto 10 years. This goes against the principles of safe banking, which demands that maturities of assets and liabilities should match. Failure to do so exposes banks to 2 types of risk³¹. If there is a sudden outflow of deposits, banks may not be in a position to repay depositors since their money is tied up in securities with long maturity. And if deposit rates were to rise suddenly to over 13.5% banks will be making losses on their investments which yields less than that amount. The fault lies with the concept of Capital adequacy which by concentrating solely on the risk involved in credit defaults, has made banks oblivious of other types of business risks.

NOTES

1. Niranjana Rajadhyaksha, "Beefing up the base", Business World, P 120, Jan 26-Feb 8, 1994.
2. Ibid.
3. Ibid.
4. "Indian Banks - Trauma of 92-93", Capital Market, P 8, Sept 8-26, 1993.
5. D.G.Gupte, "A total revamping of operations is the only way out", The Business and Political Observer, Nov 1, 1993.
6. Ibid.
7. Ibid.
8. Ibid.
9. Ibid.
10. Mohan N. Patted, "Putting banks back on rails", Financial Express (Bombay), Feb 10,

1994.

11. Supra, n.1.
12. Ibid.
13. Tamal Bandopadhyay, "Profit making banks ploy to get more cash", Business Standard (Calcutta), Feb 4, 1994.
14. Ibid.
15. "Banks to be allowed to enter capital market", Indian Express (New Delhi), Sept 4, 1993.
16. Sourav Majumdar , "Nationalised banks authorised capital to be raised", Financial Express (Bombay), Jan 23, 1994.
17. Ibid.
18. Ibid.
19. Ibid.
20. Ibid.
21. Gouri Gurumurthy / George Albert, "Bank losses set off against capital proposed ", Business Standard (Calcutta), Jan 18, 1994.
22. Ibid.
23. "Banking on the public", The Statesman (Calcutta), Dec 18, 1993.
24. Supra, n.5.
25. Ibid.
26. Ibid.
27. Ibid.
28. Supra, n.1.
29. Ibid.
30. Ibid.
31. Ibid.

ASSET CLASSIFICATION, INCOME RECOGNITION AND PROVISIONING

For a long time, Banks in India were not having any uniform accounting norms with regard to classification of assets, recognition of income and provisioning of bad and doubtful debts. In the absence of standard accounting norms, the Bank managements used to disclose higher operating and net profits by taking shelter under the prescribed format of the bank balance sheets and by resorting to window dressing operations¹. Banks were crediting the interest on their loans to the income account even when the borrower has not paid the interest on them. Non performing assets have turned out to be a major factor affecting the profitability of the banks. In the past, most banks used to take income even on non-performing assets on accrual basis. Thus their income used to get inflated helping them to disclose profits. These unreal profits were slowly eroding the capital base of the banks through unjustified tax and dividend payments besides making the financial system lose their credibility².

In order to put an end to this type of obnoxious accounting procedure, the Narasimham Committee had recommended the adoption of the international practice of charging interest to the loan accounts only when it is actually paid by the borrower³. Internationally income from non-performing assets is not recognised on accrual basis and is booked as income only when it is actually received. Narasimham Committee has recommended that a policy of income recognition should be objective and based on record of recovery than on subjective considerations⁴. It has also suggested that classification of assets should be done on the basis of an objective criteria which ensures a uniform and consistent application of norms.

The Committee has defined non-performing assets as advances where, as on the date of the balance sheet, the interest remains past due for a period of more than 180 days in the case of term loans. In respect of other accounts any receivable amount remaining past due for more than 180 days will be treated as NPA. Finally an amount is considered past due when it is outstanding for 30 days beyond the due date⁵.

Following the suggestion of Narasimham Committee report, Reserve Bank of India by its Circular dated April 27, 1992, decided that recommendations regarding income recognition, asset classification and provisioning for bad or doubtful debts in accounts on prudential basis should be implemented in a phased manner over a 3 year period commencing from accounting year April 1992⁶. The guidelines have been issued in pursuance of the Reserve Bank of India's decision to accept with certain modifications, the recommendations of the Narasimham Committees, Report on the Financial system. In framing the guidelines, Reserve Bank of India has followed the recommendations of the Committee on how to make the balance sheet reflect the actual health of a bank.

The Reserve Bank of India has directed banks not to charge and take into account interest on all non-performing assets, which has been defined as a credit facility in respect of which interest has remained unpaid for a period of 4 quarters during the year ending March 31, 1993, 3 quarters during the year ending March 31, 1994 and 2 quarters during the year ending March 31, 1995 and onwards⁷. Further an amount under any of the credit facilities, term loans, overdrafts and cash credit accounts, bills purchased and discounted and other accounts has to be treated as past due, when it remains outstanding for

30 days beyond due date⁸.

The main factor which will adversely affect the bank's balance sheet is the guideline that interest accrued and credited to income account in a prior accounting period with respect to NPA should be reversed or provided for in the current accounting period, if not collected⁹. The guidelines further add that interest income from assets in respect of a borrower if not being realised, fees, commission and similar income with respect to the same borrower that have been accrued should be reversed or accounted for with respect to past periods¹⁰.

Hitherto, income from advances was recognised on the basis of "Health Code Classification" which classifies assets into 8 categories. In 1986 the Reserve Bank of India issued a Health Code for indicating the quality (or health) of individual advances where by the advances were put into the following 8 categories¹¹:

1. Satisfactory
2. Irregular
3. Sickly viable (under nursing)
4. Sickly non viable (sticky)
5. Advances recalled
6. Suit filed Accounts
7. Decead debts and
8. Bad & doubtful debts.

In respect of Advances falling in "Health Code 4" income is being recognised taking into account the prospects of realisability of the security. Income in

respect of advances covered by health code 5 to 8 is not being recognised until it is realised¹².

At present instead of 8, the guidelines have classified the advances into 4 broad groups - Standard assets, sub-standard assets, doubtful assets and loss assets¹³. The Reserve Bank of India has laid down the following definitions for the classification¹⁴ -.

1. Standard asset is one which is not a non-performing asset and which does not disclose any problems nor carry more than normal risk attached to the business.
2. Sub-standard asset is one which has been classified as NPA for a period not exceeding 2 years. In such cases, The current net worth of the borrower/guarantor or the current market value of the security charged is not enough to ensure recovery of the dues of the bank in full. In the case of term loans, those where instalments of Principal are overdue for periods exceeding one year but not exceeding 2 years should be treated as substandard.
3. A doubtful asset is one which has remained a non- performing asset for a period exceeding 2 years. In the case of term loans, those where instalments of principal have remained overdue for a period exceeding 2 years should be treated as doubtful. Mere rescheduling should not be a criterion to upgrade the quality of an advance automatically as in the case of sub- standard assets.
4. A loss asset is one where loss has been identified by the Bank or internal or external auditors or the Reserve Bank of India Inspection but the amount has not been written off, wholly or partly.

The Reserve Bank of India has laid down quantum of provisions on the various loan accounts as under¹⁵:

1. "loss assets - The entire assets should be written off. If the assets are permitted to remain in the books for any reason, 100% of the outstanding should be provided for.

2. Doubtful assets -

a) 100% to the extent to which the advance is not covered by the realisable value of the security to which the Bank has valid recourse and the realisable value is estimated on a realistic basis.

b) Over and above item (a), depending upon the period for which the asset has remained doubtful, 20% to 50% of the secured portion on the following basis. 20%, 30% and 50% for the period if the advance has been considered a doubtful upto one year, 1 to 3 years and more than 3 years respectively.

3. Substandard assets;- A General provision of 10% of total outstanding.

Even though all advances irrespective of quantum are to be brought under classification of assets into standard, sub-standard, doubtful and loss assets, Reserve Bank of India has permitted exemption for loans with a liability of less than Rs.25,000 for which only a general provision of 25% will have to be made¹⁶. In a circular issued on March 23, 1993, Reserve Bank of India after reviewing provisions to be made for sub-standard and doubtful advances suggested that 30% provision of the asset be made in

accounts for year ended 31.3.1993 and balance provision be made compulsorily in accounts for the year 31.3.1994¹⁷. In a circular dated December 17th 1992, Reserve Bank of India has issued further clarifications stating that net worth of borrower/guarantor should not be taken into account for the purpose of treating advance as NPA or otherwise¹⁸. It has stated that all the facilities granted to a borrower will have to be treated as NPA and not the particular facility or part thereof which has become irregular¹⁹. To bring uniformity in respect of consortium advance, classification adopted by the leader of consortium should be adopted by the members.

It is well accepted that if a balance sheet is to reflect banks actual financial health, a proper system of recognition of income, classification of assets and provisioning for bad debts on a prudential basis is necessary. However the concept of managed transition is welcome as it will lend stability though it may cause anomalies.

It will be noticed that the effect of the above directions is that in case of NPA, the banks will have to make provision in their accounts in respect of total facilities granted to the unit. In respect of units which are declared sick units under provisions of Sick Industries Special Provision Act the scope for raising additional finance to make unit viable becomes difficult. The unit may require need-based working capital facility to attain its full capital utilisation or it may require additional investment to restructure plant facilities by technological upgradation. Under the above guidelines if the unit is NPA and is classified as substandard asset, the banks may be reluctant to give additional facility which is essential for the viability of the unit, simply because it will have to make provision for 50% of the additional finance given to the unit.

Further even if unit commences repayment as per revised schedule, Reserve Bank of India guidelines prohibit classification for assets for two years²⁰. The norms fixed by Reserve Bank of India are too rigid and need to be reconsidered. In today's fluid and much more competitive environment, it is necessary to get away from rigid specific norms and instead devise more flexible company specific, technology specific, demand specific and product specific guidelines²¹.

Similarly a unit may not have defaulted in respect of a particular facility say, working capital facility, but may have been in default in respect of Term loan. In such a case to make full provision in accounts for total facility is unreasonable. This seems to be rather harsh, particularly for a unit which shows positive signs of revival. It is suggested that provision be made in respect of such facility which has become irregular and not for the entire facility²².

The effect of the new norms are significant which is evidenced from the fact that as against 18 Public Sector banks (other than SBI) which made profit in 1991-1992, only 7 Public Sector Banks could make profit for the year ended 1992-93²³. The losses of the remaining Public Sector Banks ranged from Rs.75 crores to as much as 753 crore²⁴. The impact of the new norms would have been still severe but for Reserve Bank of India's relaxation with regard to definition of NPA. The recommendations of Narasimham Committee would be fully effected in the 3rd year of implementation during 1994-95, when arrears of instalment and / or interest not recovered within 6 months from due date will also be classified as NPA²⁵. This means larger portion of advances

of Banks will fall under the category of non-performing for which provision has to be made besides reducing the income earning capacity of the banks.

Of course the new prescriptions of the Indian Banking system have come to match International Standards but the role of Indian Banks has been shaped up over the years to act as a catalytic agent for social change. It is doubtful whether banks in leading countries have such a social accent as we have in India. Considering this aspect what has been prescribed for Indian Banks appear to be burdensome. No doubt, qualitative aspects of credit portfolio of banks need much improvement but given the historical background of Indian Banks and the social obligations cast on them, the new norms could have been implemented in stages so that some breather would be available to banks for readjusting themselves to the new prescriptions by bringing about organisational and structural changes and speeding up the recovery programme. The implementation of these norms appear to have come on the Indian Banking scene without due notice and as a result banks were caught unaware of their own working result. These have also brought about serious image effect on the banking system.

One thing is evident, Banks have now learnt what is Commercial banking. Hitherto banks have mobilised large resources by way of deposits regardless of its cost and vied with each other to claim top ranks in the industry. The scene has now changed. It is now equally important that the resources mobilised are profitably deployed without affecting its quality. Deposits cannot be accepted for deposits sake. Its cost effect has to be understood. Because of too much emphasis laid on deposit mobilisation most of the branches allot meagre time on advances. while no doubt resource mobilisation is an on going process of the banks, equal time and importance have to be allotted for follow-up

of advances and recovery. Banks have to bring about efficient recovery management for not only recovering non-performing assets but preventing other performing assets slipping to non-performing in due course on account of lack of follow up.

Some banks have started giving targets to the branches for reducing NPA by 10% and recover the dead amounts²⁶. As on September 1992 the banks had 29.3% of dead loans locked with larger and medium industry 20.2% with SSI, 19.70% with agriculture, 15.16% with other priority sector and 15.62% in other sectors²⁷.

Reforms with a human face is the philosophy of the government. There is need to hasten slowly on financial sector reforms particularly in respect of making provisions in accounts. To maintain stability, ill effects of anomalies and hardships caused by directions be either removed or kept to a minimal. Otherwise there is every likelihood that rigidity in enforcing discipline in banks may prove counter productive.

The 20 Nationalised Banks taken together have shown a small operating profit of Rs.797 crores for the year ended March 1993²⁸. With massive provisions and contingencies of Rs.4444 crore they have reported a whopping net loss of Rs.3647 crore²⁹. Only 7 banks have reported a total net profit of Rs.115 crore for the year. While the remaining 13 banks have reported a net loss of Rs.3762 crores³⁰. Further 11 out of 20 banks have reported an operating profit. While the remaining 9 have shown an operating loss³¹. All the banks have been obliged to make sizable provisions and provide for contingencies totaling Rs.4344 crore³². (For details refer Table 1 and 2)

The largest amount of provisions and contingencies is by Indian

Overseas Bank (Rs.706 crore) engendering the largest net loss of Rs.753 crore during 1992-93³³. This is followed by Syndicate Bank with provisions and contingencies of Rs.566 crore leading to a net loss of Rs.670 crore³⁴. UCO Bank has shown a net operating loss of Rs.113. crore and a net loss of Rs.444 crore, after provisions of Rs.331 crore. United Bank of India has Rs.121 crore as operating loss, Rs.158 crore for provisions and Rs.279 crores as net loss³⁵.

Bank of India has reported an operating profit of Rs.108 crore but with provisions totaling Rs.439 crore, there is a net loss of Rs.331 crore³⁶. Central Bank of India has an operating loss of Rs.50.crore and a net loss of Rs.383³⁷. crore after provisions of Rs.333 crore. Canara Bank has shown an operating profit of Rs.461 crore for 92-93. However with provisions of Rs.435. crore, the bank has earned a net profit of only Rs.26 crore against Rs.157 crore in the previous year (when provisions had amounted to Rs.354.crore)³⁸. Bank of Baroda has reported a much smaller net profit of Rs. 8.crore after provisions of Rs. 335.crore (Rs. 317 crore)³⁹. Punjab National Bank has an operating profit of Rs. 258 crore, provisions of Rs. 220 crore and a net profit of Rs. 21 crore⁴⁰. Oriental Bank of Commerce has an operating profit of Rs. 57 crores, provisions of Rs. 36 crore and net profit of Rs. 21. crore⁴¹. Union Bank of India has reported an operating profit of Rs. 70 crore and net profit of 11 crores after provisions of Rs. 59. crores⁴². Indian Bank's operating profit is Rs. 113.crore but the net profit is only 7.crores after provisions of Rs. 106 crore⁴³. Corporation Bank has disclosed an operating profit of Rs. 48 crore and net profit of 4 crore after provisions of Rs. 44. crore⁴⁴. The State Bank of India has reported a net profit of Rs. 212. crore for 92-93 against Rs. 175 crores in the previous year, after provisions of Rs. 1641 crore (Rs. 2414 crore)⁴⁵.

TABLE 1
PROVISIONING REQUIREMENT OF BANKS.

Banks	Sub-std assets 30%	Doubtful Assets 30%	Advances Less than Rs.25,000	Loss Total	Others	Tax	Total	
SBI	82.20	453.00	22.50	1581.00	2138.70	1889.00	323.00	4350.00
CBI	8.40	27.60	12.00	85.00	133.00	70.00	36.00	239.00
BoB	19.50	87.00	10.50	635.00	752.00	75.00	50.00	877.00
PNB	22.36	118.02	19.55	30.46	190.39	101.17	82.00	373.56
OBC	2.25	17.83	1.68	1.00	22.76	8.98	32.25	60.99
Corpn	1.20	11.20	1.40	nil	13.80	7.85	11.73	33.38
Union	7.50	51.60	21.90	60.00	141.00	68.00	20.00	229.00
BoI	123.60	340.80	7.50	373.00	844.90	260.00	50.00	1154.90
IoB	10.80	66.30	6.60	843.00	926.70	10.00	---	936.70
NBI	9.78	52.57	0.91	45.88	108.94	12.73	5.73	127.40
P&SB	6.75	52.30	12.08	66.62	137.75	54.60	-	192.35
UCO	18.90	95.40	0.60	431.00	545.90	142.80	-	687.90
Uni- ted	4.80	94.59	0.03	66.45	165.89	34.12	-	199.89

Source : Economics Times (Bombay), 13th May 1993.

TABLE 2

BANK	Profit before Provisions			Provisions			Profit after Provisions		
	92-93 (Rs.Cr)	91-92 (Rs.Cr)	Change %	92-93 (Rs.Cr)	91-92 (Rs.Cr)	Change %	92-93 (Rs.Cr)	91-92 (Rs.Cr)	Change %
S B H	105.58	135.04	-22	88.56	122.29	-28	17.02	12.75	+33
S B I	1853.58	2588.59	-28	1641.54	2413.54	-32	212.04	175.05	+21
Union Bank	70.47	154.28	-54	59.21	124.83	-53	11.26	29.45	-62
Indian Bank	112.11	101.97	+10	105.60	65.47	+61	6.51	36.50	-82
Canara Bank	461.65	510.34	-10	435.49	353.75	+23	26.07	156.59	-83
B O B	343.16	411.97	-17	334.93	316.87	+6	8.23	95.10	-91
C B I	-49.82	123.19	-140	333.49	92.70	+260	-383.31	30.49	-1357
Total	2896.64	4025.38	-28	2998.82	3489.45	-14	-102.18	535.98	-119

Source - Capital Market, Sept 13 - 26 1993.

NOTES :

1. Infra, n. 11
2. M.J.Subramanyam , "Two years of banking reforms", Financial Express (Bombay), Nov 1, 1993).
3. Report of The Committee On The Financial System, (M.Narasimham , Chairman), Nov 1991,P. 55.
4. Ibid.
5. Ibid.
6. Khando Ballal, "Asset classification, Income recognition and Provisioning", Financial Express (Bombay), Dec 1, 1993.
7. "How prudential norms have hurt ", Hindu (Madras), Aug 5, 1993.
8. Ibid.
9. "RBI tightens accounting parameters for banks", Economic Times (Bombay), Sept 9, 1992.
10. Ibid.
11. A.C.Tiwari, "Our banks : Some neglected areas and problems - I", Financial Express (Bombay), Aug 5, 1992.
12. Supra, n. 9.
13. Ibid.
14. Ibid.
15. Ibid.
16. R.Narasimhan, "Implementation of new banking norms", Financial Express (Bombay), Jan 26, 1994.
17. Supra, n. 6.
18. Ibid.
19. Ibid.
20. Ibid.
21. Ibid.

22. Ibid.
23. Supra, n. 16.
24. Ibid.
25. Ibid.
26. P.D.Sharma, "Banks after nationalisation", Tribune (Chandigarh), Feb 7, 1994.
27. Ibid.
28. D.G.Gupte, "A total revamping of operations is the only way out", The Business and Political Observer, Nov 1, 1993.
29. Ibid.
30. Ibid.
31. Ibid.
32. Ibid.
33. Ibid.
34. Ibid.
35. Ibid.
36. Ibid.
37. Ibid.
38. Ibid.
39. Ibid.
40. Ibid.
41. Ibid.
42. Ibid.
43. Ibid.
44. Ibid.
45. Ibid.

PROPOSAL FOR NEW BANKS IN THE PRIVATE SECTOR

The USA has been exerting pressure on the Indian government through the threat of imposition of sanctions under super 301 to throw open the business of banking and insurance to the private sector including foreigners. Even the International Monetary Fund (IMF) and the World Bank have been influenced by the USA to make this a condition for provision of aid. India had no alternate but to succumb to it.

The announcement that RBI had accorded consent in principle to the setting up of banks in the private sector marks the reversal of half-a century old history during which practically no new full fledged commercial bank has been established in India. Bharat Overseas Bank set up jointly by 3 nationalised banks in 1973, for a specific purpose can be called an exception, though only technically¹.

The process of setting up of new banks came to an end with the introduction of the Bill for regulation of banking, in the central legislature in 1944, which aimed at curbing the malpractices observed in banks particularly those which had sprung up after the commencement of World War II. The provisions of the Bill left a widespread impression that owning and managing new banks would no longer be a worthwhile proposition either commercially or as a source of power. The Banking Companies Act 1949 (Since renamed Banking Regulation Act) which ultimately followed the Bill, prescribed the need for a licence from RBI for starting a new bank in India. The number of banks on the other hand started going down from 700 at the end of 1944 and gradually came down to around 70 by 1968 mostly as a result of voluntary closures, mergers and amalgamations².

With the introduction of social control over banks in 1967 which marked the commencement of the era of directed credits and priority sectors and more so with the nationalisation of the top 14 private banks in July 1969, which practically (though not statutorily) barred fresh entry of the private sector into the banking arena, the possibility of any new banks being set up got more or less ruled out.

The situation changed with the release in Nov 1991 of the report of the Narasimham committee which had recommended that there should be no bar to new banks in the private sector being set up, subject to their conforming to certain RBI norms.

While making the recommendation, the Narasimham committee however had not suggested the removal of any of the regulations except one (branch licencing introduced in 1946) which governed the operations of banks during the years 1944-1969 during which practically no new banking ventures were floated in the country. Most of the major constraints, the removal of which Narasimham committee has suggested relate exclusively to the post nationalisation period. These are for e.g. apprehensions of further nationalisation, difference in treatment accorded to banks in private and public sector, excessive administrative and political interference in individual credit decisions and in managements, high percentage of advances to priority sector, excessive SLR requirements and so on. Hence the main factor behind the revival of private banks is obviously the change in approach and in the style of administering the old regulations (rather than changes in the regulations themselves) which has provided the stimulus³.

The RBI ushered in a new banking era when it issued specific guidelines for the entry of Private sector banks on Jan 22nd 1993.

The following are the guidelines for the entry of new private sector banks⁴.

1. The Bank shall be registered as a public limited company under the companies Act, 1956.
2. The RBI may, on merits grant a licence under the Banking Regulation Act, 1949, for a bank. The bank may also be included in the second schedule of the Reserve Bank of India Act, 1934 at the appropriate time. The decision of the RBI in these matters shall be final.
3. The Bank will be governed by the provisions of the Banking Regulation Act, 1949, in regard to its authorised, subscribed and paid-up capital. The minimum paid-up capital shall be Rs 100 crores. The promoters contribution shall be determined by the RBI and will also be subject to other application regulations.
4. The shares of the bank should be listed on stock exchanges.
5. To avoid concentration of the head-quarters of new banks in metropolitan cities and other overbanked areas, while granting a licence, preference may be given to those, the headquarters of which are proposed to be located in a centre which does not have the headquarters of any other bank.
6. Voting rights of an individual shareholder shall be governed by the ceiling of 1% of the total rights as stipulated by section 12(2) of the Banking regulation Act. However, exemption from this ceiling may be granted under sec 53 of the said Act, to public financial institutions.
7. The bank shall not be allowed to have as a director, any person who is a director of any

other banking company, or of companies which among themselves are entitled to exercise voting rights in excess of 20% of the total voting rights of all the shareholders of the banking Company, as laid down in the Banking Regulation Act, 1949.

8. The bank will be governed by the provisions of the Reserve Bank of India Act, 1934, the Banking Regulation Act, 1949 and other relevant statutes, in regard to its management, set-up, liquidity requirements and scope of its activities. The directives, instructions, guidelines and advices given by the RBI shall be applicable to such a bank as in the case of other banks. It would be ensured that a new bank would concentrate on core banking activities initially.
9. The bank shall be subject to prudential norms in respect of banking operations, accounting policies and other policies as laid down by RBI. The bank will have to achieve capital adequacy of 8% of the risk weighted assets from the very beginning. Similarly, norms for income recognition, asset classification and provisioning will also be applicable to it from the beginning. So will be the single borrower and group borrower exposure limits that will be in force from time to time.
10. The bank shall have to observe priority sector lending targets as applicable to other domestic banks. However, in recognition of the fact that new entrants may require some time to lend to all categories of the priority sector, some modifications in the composition of the priority sector lending may be considered by the RBI for an initial period of 3 years.
11. The bank will also have to comply with such directions of the RBI as are applicable to existing banks in the matter of export credit. As a facilitation of this, it may be issued an authorised dealers licence to deal in foreign exchange when applied for.
12. A new bank shall not be allowed to set up a subsidiary or mutual fund for at

least 3 years after its establishment. The holding of such a bank in the equity of other companies shall be governed by the existing provisions applicable to other banks viz

- a) 30% of the bank's or the investee company's capital funds, whichever is less, as set out under the Banking Regulation Act, 1949 and
- b) 1.5% of the bank's incremental deposits during a year as per RBI guidelines.

The aggregate of such investments in the subsidiaries and mutual fund (if and when set up) and portfolio investments in other companies shall not exceed 20% of the bank's own paid-up capital and reserves.

- 13. In regard to branch opening, it shall be governed by the existing policy that banks are free to open branches at various centres including urban/ metropolitan centres without the prior approval of the RBI once they satisfy the capital adequacy and prudential accounting norms. However, to avoid over-concentration of their branches in metropolitan areas and cities, a new bank will be required to open rural and semi-urban branches also, as may be laid down by RBI.
- 14. The bank shall have to lay down its loan policy within the overall policy guidelines of RBI. While doing so, it shall specifically provide prudential norms covering related party transactions.
- 15. The bank shall make full use of modern infrastructural facilities in office equipment, computer, telecommunications, etc. in order to provide good customer service. The bank should have a high-powered customer grievances cell to handle customer complaints.
- 16. The bank shall have to satisfy such other conditions as RBI may prescribe from time to time.

Here it is to be noted that certain amendments were made in the Banking Regulation Act, 1949 through an ordinance in Feb. 1994⁵. The promulgation of the ordinance to bring about the changes in the Act underlines the urgency the govt. attaches to the setting up of banks in the private sector.

The ceiling on voting rights of a shareholder in a banking Company has been raised from the present 1% to 10%⁶. This will allow promoters of private sector banks to exercise voting rights up to 10%. The Act has been amended to allow splitting of the post of chairman and Managing director⁷. The ordinance provides for a part-time non-executive chairman. The existing provisions stipulate that a bank is to be headed by a chairman-cum-managing director. This provision will not only allow the private sector banks with the flexibility of choosing between the two managerial structures but will also enable the govt. to bring about a change at the top management of the nationalised banks. The finance ministry is reportedly keen on changing the top heavy structure of the banks to infuse a sense of team work in the emerging competitive environment.

The penalties provided for contravention of the provisions of the Act have also been revised upwards so that they have the necessary deterrent effect. For contravention or defaults by persons the penalty has been raised from Rs 2000 to a minimum of Rs 50,000, while for banking companies the penalty has been increased from Rs 2000 to a minimum of Rs 5 lakhs⁸.

Barring a few restrictions, the overall reaction of the bankers to the RBI

guidelines is favourable.

Banking services in India will never be the same again. The catalysts of this inevitable change will be the new private sector entrants in the banking industry. The traditional concept of directed lending in a regime of regulated interest rates and the age-old products and standard services will be replaced by a competitive environment with improved customer services and innovative products. The new aspirants of private sector are gearing up to bring in a new banking culture by offering services of international standard and quality. They will introduce greater competition which will lead to higher productivity and efficiency in the banking system. Infact the move to allow fresh entrants has already created a competitive environment in the industry. The existing public sector banks and the private banks are trying to diversify their business and improve efficiency and productivity. They will also have a direct impact on the working of the existing Indian and foreign banks who will have to face severe competition in deposit mobilisation and other services.

At least four privately owned domestic banks have already been granted permission under the new guidelines, to foster a healthy competition within the players of the financial system. The first three private banks will be set up by the Industrial Credit and Investment Corporation of India (ICICI), Housing development & Financial Corporation (HDFC) and the Unit Trust of India (UTI). It has been reported that IFCI has also been granted permission. The other aspirants are Exim Bank, 20th Century finance and ITC.

The advantage of the new institutions will be their present connections

with the corporate bodies, whose multi-ferrous banking functions they propose to take over. All these banks are expected to be operative within a year and all are aiming at high tech systems with best customer service.

Bankers believe that even this limited entry of new banks will pave the way for a revolutionary change in the banking industry. This is evident from what the promoters of the proposed banks are planning. The UTI, for instance is going in for the most advanced system of banking. Says Basudeb Sen, General Manager, UTI, "Our objective would be to offer class services to the masses"⁹. Currently only some foreign banks are offering international banking services in India. Their concept is "class services to the elite" as their operations are confined to big cities. UTI bank with a paid-up capital of Rs 100 crores will have 7 branches initially with headquarters at Ahmedabad. "The banking service we visualise is to execute or process financial transactions efficiently to the satisfaction of the customers. The traditional role of lending and accepting deposits will be secondary objectives" adds Sen¹⁰. The bank will gradually become a financial supermarket catering to the diverse needs of its clientele.

HDFC, on the other hand plans to go in for wholesale banking, with an initial paid up capital of Rs 300 crores. It plans to have 4 branches in the metropolitan centres with its headquarters at Bombay. It will be focusing on corporate finance, foreign exchange and export business. It expects to finance exports of diamonds and textiles from its Bombay office, ready-made garments from Delhi and marine exports from Goa¹¹. Both HDFC and UTI banks will be entering the capital market. While UTI wants to gradually reduce its holdings to 40% HDFC will be bringing it down to 20% in a phased manner¹².

The ICICI also plans to go in for whole-sale banking with innovative products. More emphasis will be given on non-fund business like guarantees, foreign exchange risk management, cash management services and treasury services. It will have a paid-up capital of Rs 100 crores with its headquarters at Bombay¹³.

Technology will form the corner stone for each of the private sector banks. Qualitative service, with computerised and mechanical devices, with least faults will give them an edge over the nationalised banks and to some extent over the foreign banks as well. With computers and modern innovative money market instruments the new entrants can easily beat them in performance and profitability. But the volatile market, increasing competition from banks and non-banking financial companies and the deregulated environment will make life riskier for banks. Those with better risk management technique will have an edge over others in improving their earnings.

As per the RBI guidelines the new banks will be subject to the prevailing instructions of statutory liquidity and Cash Reserve Ratios, interest rate ceiling and also compulsory deployment of funds in the priority sector. They will also have to meet the capital adequacy ratio of 8% right from the beginning and should have branches in rural and semi-urban areas. However for other matters like issue of dividends and bonus shares RBI has agreed to relax some norms for private sector banks¹⁴. RBI is ready to allow them to declare a dividend of upto 25% with prior approval but permission will be required beyond this limit¹⁵. At present private banks are prevented from issuing bonus shares. Needless to say, they will automatically be subject to all other regulatory and supervisory rules of the RBI. In this connection two of Narasimham committees suggestions were that internal

organisation of banks be best left to the judgment of the bank's management and that controls should be more through prescription of prudential norms and "off site" rather than "on site" supervision¹⁶. Both these are suggestive of restoration of a large part of the autonomy which the bank managements enjoyed during the pre-regulation period.

Here, it has to be remembered that the banking system in India has undergone one of the worst upheavals during the months following the publication of the Narasimham committee's report. Narasimham committee did not have the slightest idea of some of the malpractices which were brewing in banks and which came to light with the uncovering of the securities scam. In this scenario it may not be possible to introduce relaxations in the style of control over banks on the lines recommended by the committee. If for no other reason such changes will not be accepted politically.

One significant indication of change in thinking is that while the Narasimham committee called the banking system "over-regulated" and "over administered" in Nov 1991, the ministry of Finance in its discussion paper on economic reforms published in July 1993 has called the system "over regulated" but "under governed"¹⁷. Government's perception is thus materially different from that of Narasimham committee apparently because of the surfacing of the scam during the interregnum. The winds have started blowing once again in the direction of tighter rather than lesser supervision.

The rules in regard to opening of branches, also falls short of Narasimham committee's recommendation for outright abolition of branch licencing. Government has already signified its non-acceptance of the committee's recommendation

regarding reduction in the percentage of priority sector loans. All these are pointers to the possibility of not only retention but at places strengthening of the regulatory framework, leaving the banks little scope for making easy money which some foreign banks have been doing for long. So it will be naive to assume that the proposed new banks will be able to function and thrive in a world of their own, as islands of efficiency and productivity.

There is also criticism against granting of licence to new banks in such a haste by the government. According to a senior bank official, "The central bank would have done well by cleaning up the Augean stables of private banks before embarking on granting new licenses to private banks"¹⁸. Even though the RBI has allowed 4 parties to set up new private banks, 8 existing private banks are being closely monitored by the central bank for "unsatisfactory" performance. The reason being that there was an erosion in provisions, reserves, paid-up capital and even deposits¹⁹.

But RBI officials justify the arrival of new private banks on several counts. As an RBI official put it "There is an increasing need to introduce greater competition which could lead to higher productivity and efficiency in the banking system. Besides guidelines for new private banks are very tough, they will have to set up branches in rural and semi-urban areas, fulfill requirements for priority sector and meet the capital adequacy of 8% of the risk weighted assets right from inception"²⁰.

All said and done, if private banks don't improve their performance they will have to meet the fate of their counterparts in the public sector.

The Banking system as a whole would tend to benefit from the

introduction of private banking on a large scale. There are few signs of any conflicting situations with more players in the field. In fact there would be a stronger tie of complementarity between them. The private sector banks would fill in the lacuna in terms of infrastructure a major stumbling block for the public sector banks which are hard pressed for resources in an environment which calls for better housing keeping. On the whole, private sector banks may be expected to usher in a wave of efficiency and service which is exactly what all financial sector reforms are about.

NOTES

1. R.C. Mody , "Proposal for new banks in the private sector", Financial Express (Bombay), Sept 16, 1993.
2. Ibid.
3. Ibid.
4. "Private Sector Banking - opening of a new Chapter", Capital Market, July 5-18, 1993.
5. "Banking Act Amended - limit on share-holders voting rights raised", Times of India (Bombay), Feb 2, 1994.
6. Ibid.
7. Ibid.
8. Ibid.
9. N.K. Kurup, "Private banks - Will they change the banking scene?", Indian Express (Bombay), July 26, 1993.
10. Ibid.
11. R.B.Mathur, "Banking - Towards competitive efficiency"- Business Standard (Calcutta), Nov 30, 1993.
12. Supra, n. 9.
13. Supra, n. 11.
14. Ibid.

15. Ibid.

16. Report of the Committee on the Financial system, (M.Narsimham, Chairman), Nov 1991, P 83, 130.

17. Supra, n. 1.

18. George Mathew, "Will private banks stand the test", Indian Express (Bombay), Sept 13, 1993.

19. Ibid.

20. Ibid.

PERFORMANCE -FOREIGN BANKS VIS-A-VIS INDIAN BANKS

The twenty-three foreign banks functioning in India have 138 branches. If profitability is any yardstick, their performance is enviable. During recent years they have expanded their business in the country while the Indian banks have failed to create any impact in foreign countries and are merely looked as a facility for Indians residing abroad.

The current liberalisation drive has opened the Indian market for the entry of foreign banks, but in the backdrop of the disappointing performance of domestic banks, the emerging scenario of competition does not leave any prospects for cheer for our banks. The State Bank of India occupies 134th place in the list of 1000 major banks of the world compiled by the Banker of London¹. Dai Eicher Kyegen Bank of Japan tops the list with total capital worth Rs.13,37,100 crores, while the SBI has capital totaling 94,800 crores². Even within India the foreign banks have registered phenomenal growth and outperformed domestic banks in matters of profits and deposits.

However a direct comparison between Indian and foreign banks would not be fair because the conditions under which these banks operate and their objectives widely differ. Moreover, they attract different kind of customers and have to meet different requirements. Due to stringent regulations, Indian banks often have a very low percentage of their funds available for discretionary lending. Their functioning is also subject to stringent controls. However foreign banks too have their own set of constraints. Besides being internally driven by intense competition foreign banks maintain low employment levels and pay high salaries and retain the best talent which is one reason

why their per employee productivity is generally quite high.

Citi Bank of America, American Express Bank, HongKong Bank, ANZ Grindlays, Standard-Chartered and other foreign banks steal a lead in efficiency, polished looks, customer incentives, credit schemes and lucrative pay and perks and working condition over domestic bank. These are a few reasons why they are able to corner a good chunk of business and affluent sections despite limited area of function. According to the noted economist P.R.Brahmananda, earning of other incomes accrued by way of commissions, brokerage and arbitrage for the foreign banks was 5% as against 1% by the Indian Banks³. He said more than 55% of the foreign bank assets consisted of Government securities as against 35% by the Indian banks⁴. The foreign banks being leading players in the inter bank transactions in securities also made profits through switch and swap operations, buying new bonds with higher coupon rates. He said the foreign banks also generated a high extent of bankers receipts, obtaining command over large amount of money for themselves or their brokers exploiting the imperfections of the banking system⁵. They usually kept large deposits in small banks creating a demand for the securities which in turn generated bankers receipts.

Also in the aftermath of the scam it is alleged that the phenomenal profits of foreign banks operating in India have come not from "genuine banking" but from treasury operations, from so-called portfolio management and from lending in the money market non-deposit resources, garnered essentially from other banks, financial institutions and public sector undertakings⁶. Though the involvement of several foreign banks in the securities scam has greatly undermined their credibility, it will be useful to look at the positive aspects of their functioning.

During 1991-92 the foreign banks in India earned a profit of Rs.480 crores while the nationalised banks with their vast network of branches could earn merely Rs.498 crores⁷. Citi Bank alone earned Rs.182.14 crores in the year while the vast network of SBI could yield merely Rs.175.34 crores⁸. The 3rd place went to the ANZ Grindlays Bank which earned Rs.156.91 crores by way of profits⁹. Deposits also rose spectacularly. In March 1992 their deposits stood at Rs.17,570 crores which was 7.5% of the scheduled banks¹⁰. This ratio was 3% in 1985¹¹. Their rate of growth and deposits was far ahead of those of the domestic banks. Benefiting from the relaxation in foreign currency notes for banks, they mobilised a good number of Foreign Currency Non-Resident (FCNR) deposit which proved a windfall for them. For instance 72% of the total deposits in Citi Bank are FCNR¹².

Contrary to the popular belief, according to a study made by the National Institute of Banks Management (NIBM), the level of efficiency of Indian banks is higher than that of the foreign banks operating in India¹³. Formulating a stochastic frontier production function for the banking industry, the NIBM researchers computed bank-wise technical as well as allocative efficiency rates of 51 Indian banks and 19 foreign banks and found that foreign banks as a group were one percent less efficient than the domestic banks, while the standard deviation of technical efficiency of foreign banks was slightly higher than that of domestic banks¹⁴.

The stochastic frontier is defined as an ability of a production organisation to produce a better amount of output at a minimum cost¹⁵. In this system,

a banks total value of earning assets are treated as measures of output and deposits are considered as inputs along with capital and labour. On the contrary, in the production approach, banks are seen as producers of services associated with individual loan and deposit accounts. The study which examined the relative efficiency of foreign and domestic banks in India disproved the popular belief that the superior productivity and profitability level of foreign bank was the outcome of greater operational efficiency¹⁶. Instead, the study strongly endorsed that the higher productivity and profitability of foreign banks were their particular operational characteristics and strategies as also the preferential treatment rendered to them by the government.

However, the comparison of labour / branch productivity and profitability between foreign and domestic banks revealed that the same were respectively higher for foreign banks, thus confirming the earlier findings of the Nag-Shivaswami and Keshari Committees¹⁷. Both these committees had earlier found that several factors helped foreign banks to earn greater profitability in India. These include the minimal contribution to priority sector lending, a greater involvement in highly profitable activities like bill discounting, portfolio management services, investment in securities, foreign exchange dealings, maintenance of non-resident accounts and greater involvement in real estate and consumer durable financial business¹⁸.

Based on these factors, the Narasimham Committee also emphasised that the liberal entry of foreign banks would provide spill-over benefits to the financial sector by improving competitive efficiency and by upgrading work culture and technology of the Indian banking industry. The Committee recommended an enhanced participation of foreign banks by allowing them not only to open more branches but also

to have subsidiaries and joint venture units with Indian domestic banks¹⁹.

That the foreign banks are free from the social obligation of lending to priority sector development, a prime demand with the domestic banks cannot be ignored. According to Reserve Bank of India report titled ' Review of the working of Foreign Banks in India' the foreign banks were required to advance 12% of their loans to the priority sector by 1991 which was to be enhanced to 15% by 1992²⁰. They could not even achieve the target fixed for export credit. Against this, the Indian banks are required to set apart 40% of their lending for the priority sector.

The foreign banks are independent in their choice of customers and business. They operate in metropolises while the domestic banks have to open certain number of rural branches in order to qualify for permission for a new urban branch. The rural branches and lending saps the profitability of the domestic banks while foreign banks operate free of such handicaps.

It is also an unconcealed truth that the foreign banks indulge in unethical, if not illegal practice of inducting relatives of influential people in the government and derive benefits through them²¹. Some of the nominees of the high and the mighty are given plum posts and good pay and perks. This nexus bring the foreign banks lucrative business. Significantly in the list of the personnel of the foreign banks sought by the scam related Joint Parliamentary Committee, there was found to be high officials holding top positions in the nationalised banks. Several of them were involved in the scam. Former Attorney General G.Ramaswamy had secured a Rs.15 lakh loan from the Standard -Chartered Bank without any guarantee in contravention of RBI rules²². The

Bank of America had offered Chairmanship of their Indian board to Mr. Amitava Ghosh, former Deputy Governor of the RBI²³.

Profitability and stiff mutual competition has often impelled them to ignore the RBI directives and Indian banking regulations. They came under heavy cloud following serious allegations of issuing bank receipts without security, violation of portfolio management, speculative deals, deals in Havala Market, violation of credit regulations and misuse of Public sector funds for share bazaar deals²⁴. Some of these were only a recurrence and they had first come to notice in 1990. Yet no action was taken against them by the RBI.

For these irregularities they would have been penalised and even may have forfeited their licenses in their country of origin. The Commercial Bank of Saudi Arabia in the US had to cough up heavy penalties for having certain business deals with the Bank of Credit and Commerce International²⁵. The Bank of Baroda had also to pay heavy fines in America for a minor lapse²⁶. Yet in India they got away despite grave violation of banking rules. The former RBI Governor S.Venkitaraman has been accused of showing a condescending attitude towards these banks. In this context the statement by JPC Chairman Ram Nivas Mirdha that "All grave irregularities originated from the foreign banks" has come as the most severe indictment²⁷.

But regardless of all this, the foreign banks score over the Indian banks by dint of latest information technology, new management techniques and extensive network. This indeed offers their customers a far superior transfer facility in the rapidly shrinking world. In fact they can be even said to have spurred the Indian banks into adopting these very techniques.

NOTES :

1. Harvir Singh, " The Banks that steal a lead", Daily (Bombay), May 30, 1993.
2. Ibid.
3. Indian Banks must seek level playing field", Herald (Panjim), Feb 8, 1994.
4. Ibid.
5. Ibid.
6. Aditya Samant, "Low productivity is a cause for concern", Economic Times (Bombay), July 29, 1993.
7. Supra, n. 1
8. Ibid.
9. Ibid.
10. Ibid.
11. Ibid.
12. Ibid.
13. "Study finds Indian banks more efficient", The Economic Times (Bombay), Nov 9, 1993.
14. Ibid.
15. Ibid.
16. Ibid.
17. Ibid.
18. Ibid.
19. "Domestic banks more efficient : NIBM study ", The Business and Political Observer, Nov 12, 1993.
20. Supra, n. 1.
21. Ibid.
22. Ibid.

23. Ibid.

24. Ibid.

25. Ibid.

26. Ibid.

27. Ibid.

PERFORMANCE OF BANKS IN 1992-1993¹

The year 1992-93 will go down in Indian banking history as a landmark year in which the financial sector underwent momentous changes. During the year 92-93 several recommendations of the Narasimham Committee were implemented. As a result, the impact on the profit figures of many banks, particularly on nationalised banks are very severe.

Viewed from long term perspective the new reforms will improve the inherent strength of banks by disclosure, even though the set norms may generally lead to a reduction in the surplus generated during the stabilisation period, when compared to previous years. The low profits are only a temporary phenomenon and a natural consequence during the initial years of compliance.

The 46 Indian scheduled commercial banks together incurred a net loss amounting to Rs.3316 crores in 1992-93 as against a profit of Rs.875 crores in the previous year. The huge loss incurred by 20 nationalised banks amounting to Rs.3649 crores could not be wiped out by the meagre profits of State Bank of India and its associate banks and 18 private sector banks amounting to Rs.280 crores and Rs.53 crores respectively.

State Bank group, comprising State Bank of India and its seven associate banks further consolidated its financial position during the year, despite more stringent regulatory accounting requirements. An enhanced net profit of Rs.280 crores

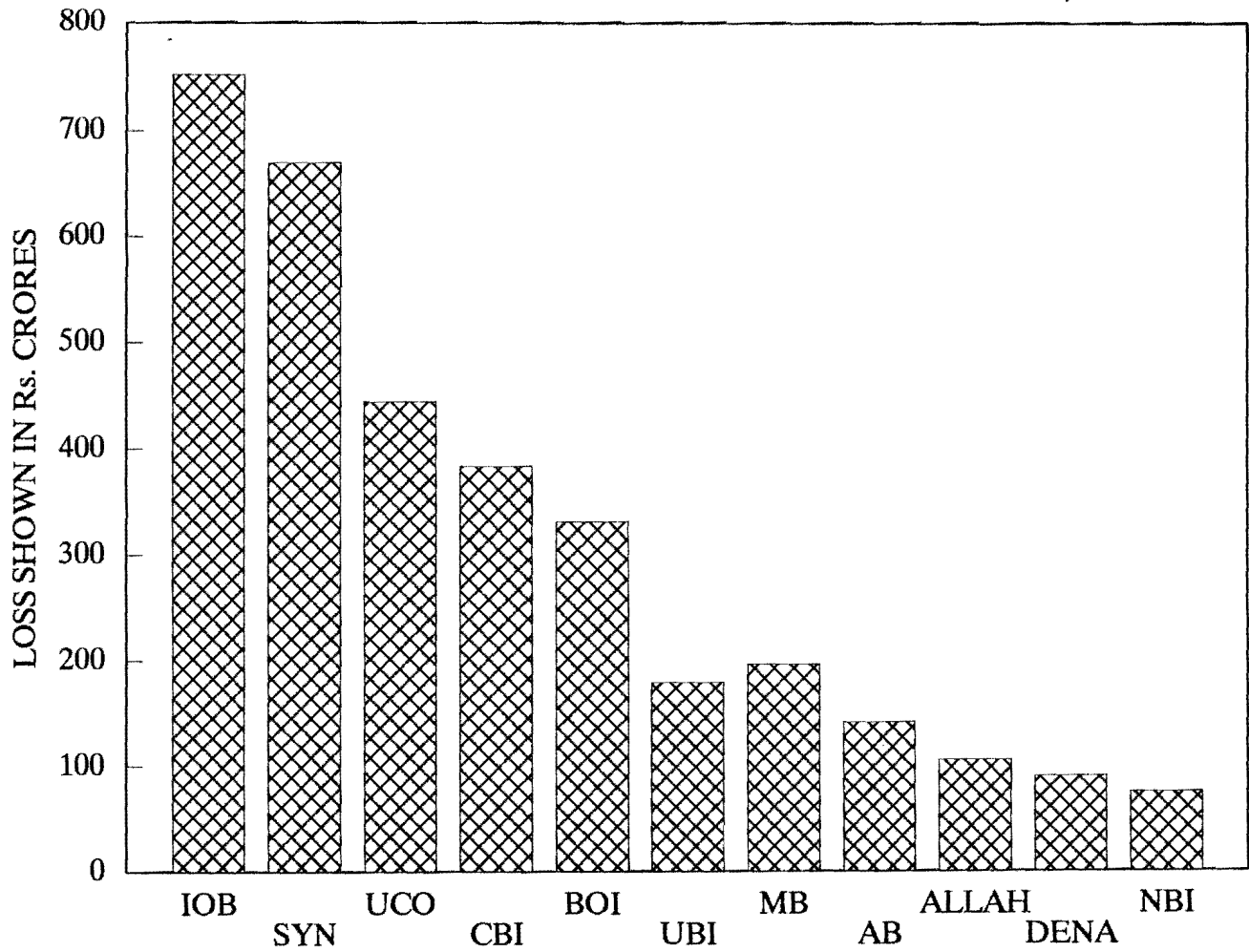
was recorded by the State Bank group in 1992-93, an improvement of 142% over the previous year's net profit of Rs.245.3 crores. The net profit of State Bank of India alone increased by 21.1% to Rs.212 crores in 92-93 from Rs.175.1 crores in the previous year. Of the seven associate banks, the net profit went up in the case of four. Two others declined and one bank maintained the previous level.

20 nationalised banks together incurred a net loss of Rs.3648.9 crores in 92-93 as against a net profit of Rs.558.5 crores in the previous year.(For details refer Graph 1). This huge loss is after providing for necessary provisions and contingencies amounting to Rs.4453 crores as per the new guidelines. The provisions and contingencies during the previous year were only Rs.1809 crore. But for the provision and contingencies as per the new guidelines, these banks would have made a net profit of Rs.804.1 crore in 92-93, showing a rise of 44% over the previous year. During the year as many as 13 nationalised banks incurred a total net loss of Rs.3763.3 crore when the remaining 7 banks together earned a net profit of Rs.114.7 crore. Thus the net profit of 20 nationalised banks worked out at Rs.3648.9 crore in 92-93.

All the nationalised banks, except seven banks, Bank of Baroda, Punjab National Bank, Canara Bank, Indian Bank, Union Bank, Oriental Bank of Commerce and Corporation Bank are in the red for the year under review. In the case of these 7 banks too, the net profit declined in 92-93 from the previous years level.

The total net profit of 18 private sector banks declined by 26% to Rs.52.7 crore in 92-93 from Rs.71.2 crore in the previous year. 7 banks showed a rise in net profit during the year under review while one bank (Lord Krishna Bank) earned a profit

LOSS SHOWN BY COMMERCIAL BANKS AS ON MARCH 31, 1993



SOURCE : BUSINESS STANDARD (CALCUTTA), AUG. 23, 1993

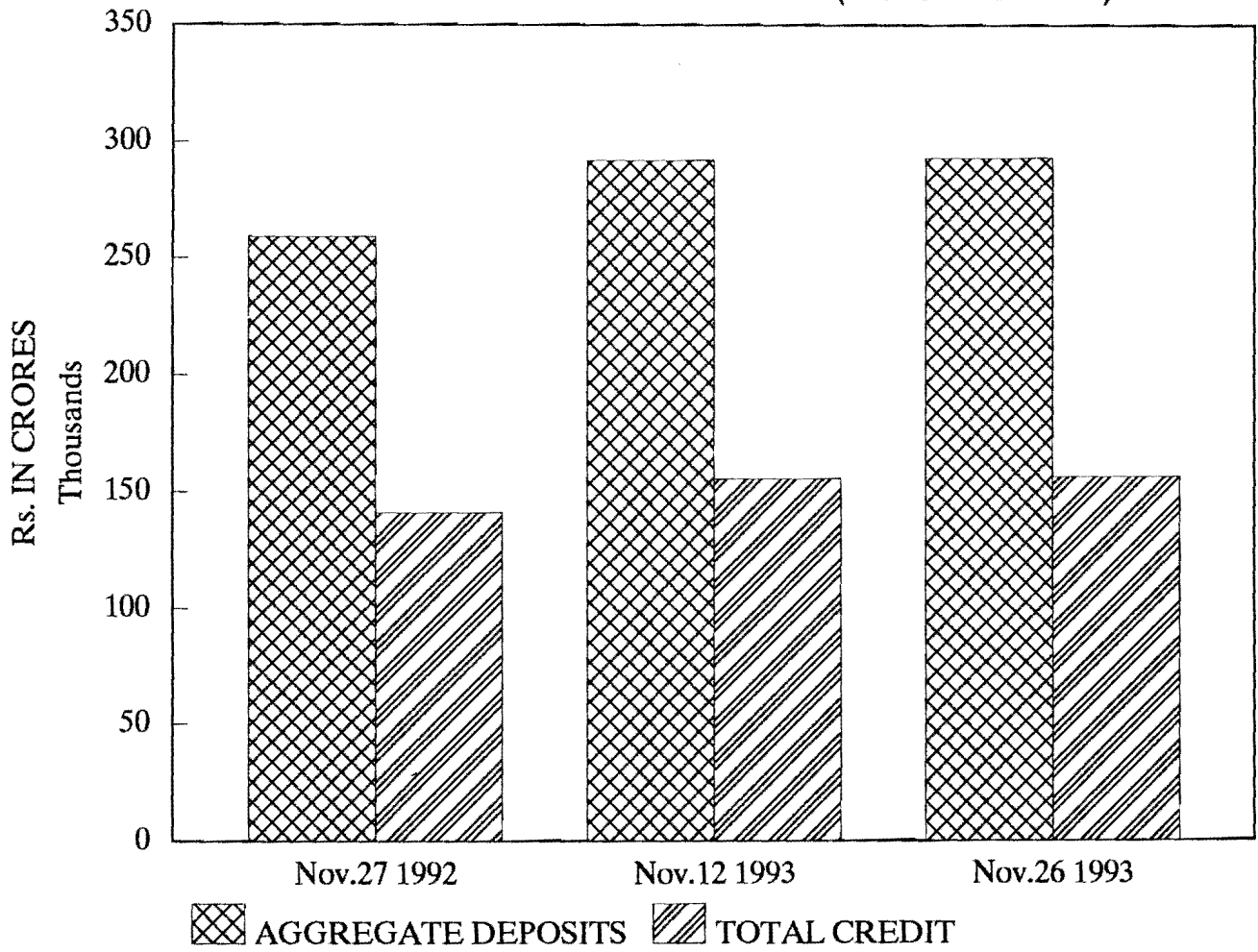
in 92-93 as against loss in the previous year; another one (Benares State Bank) incurred a loss during the year under review as against a profit in the previous year. The remaining 9 banks showed a decline in their net profit during the year under review.

Deposites and advances

The outstanding deposits and advances of the 46 Indian scheduled commercial banks at the end of March 93 stood as Rs.277456 crore and Rs.160871 crore respectively. (For details refer Graph 2). The deposits registered a lower growth of 13.2% in 92-93 as against 17.2% in the previous year. In absolute terms, the accretion to the aggregate deposits in 92-93 was Rs.32249 crore as compared with an increase of Rs.36,254 crore in 91-92. Demand deposits during 92-93 showed a very small increase of Rs. 497 crore(2%) as against an increase of Rs.11796 crore (35.8%) during the previous year. On the contrary, the time deposits have gone up by Rs.34776 crore (19.2%) as compared with previous years increase of Rs.25774 crore (15.8%). The pronounced shift from demand deposits to time deposits can be attributed primarily to rationalisation of interest rate structure on deposits brought about by the Reserve Bank of India during the year under report.

Among the Indian scheduled commercial banks, private sector banks registered the highest deposit growth of 26.4% in 92-93 as against 33.7% in the previous year. While the deposit of associate banks grew by 20.4% (16.6% in the previous year) those of nationalised banks rose by 12.8% (13.9%). In the case of State Bank of India the growth rate was only 10.2% (24.4%).

SCHEDULED COMMERCIAL BANKS (INCLUDING RRB's)



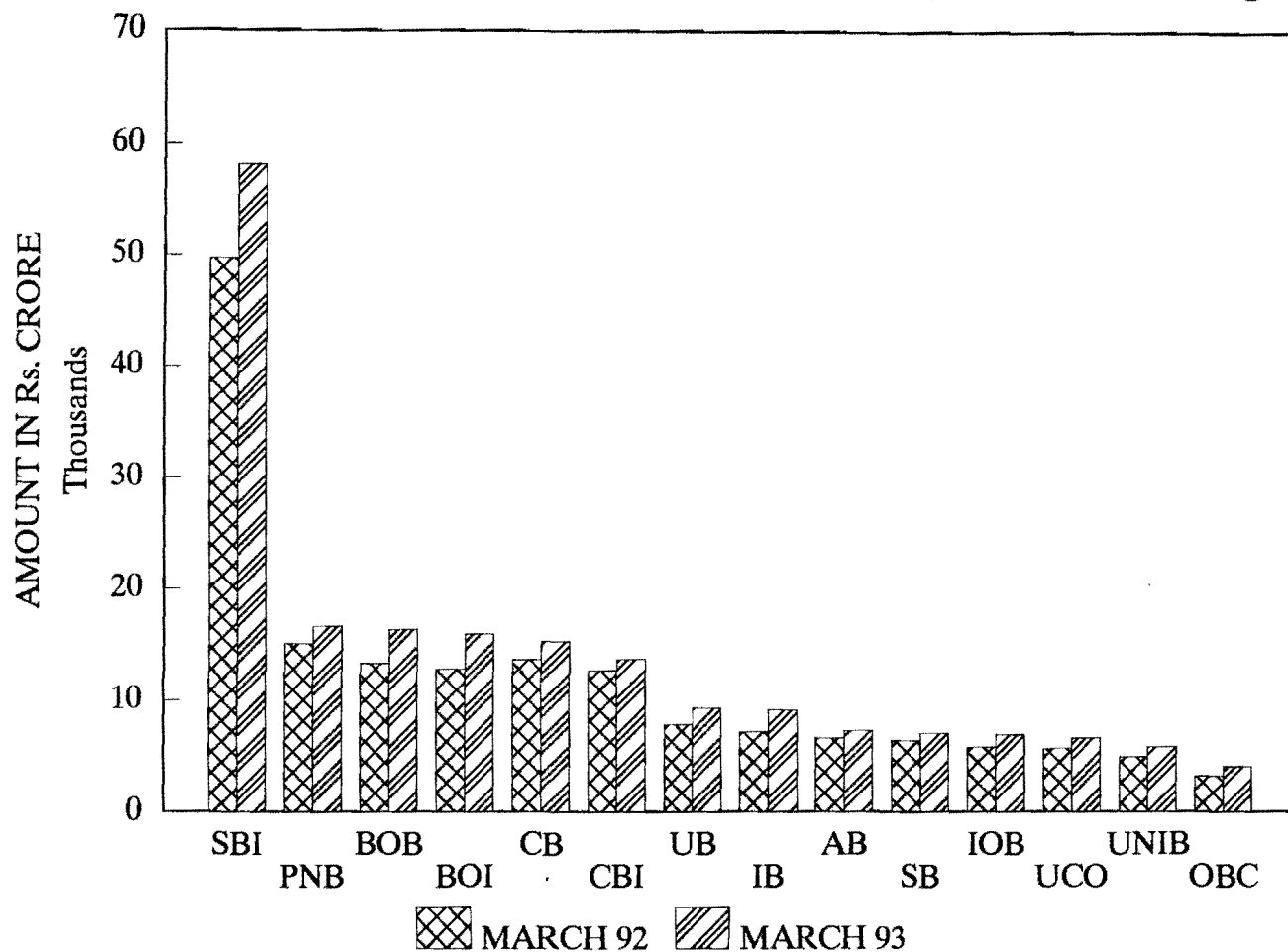
SOURCE : FINANCIAL EXPRESS (BOMBAY), 23 DEC. 1993.

Nationalised banks as a group contributed 65.1% (65.3% in the previous year) of the aggregate deposits of 46 Indian scheduled commercial banks, while the State Bank and its associates together accounted for 30.7% (30.9%). (For details refer Graph 3). The share of private sector banks in the total deposits of 46 Indian scheduled commercial banks was 4.2% (3.8%). In terms of deposits as at the end of March 93, State Bank of India a public sector bank ranked first among the Indian scheduled commercial banks with a total deposits of Rs.66317 Crore.

Subsequent to the closing of the accounts, the government issued a notification on the amalgamation of New Bank of India with Punjab National Bank with effect from Sept 4th 1993. So at the moment, Corporation Bank with deposits of Rs.2854 crore ranked last among the nationalised banks. However the deposits of 4 associated banks of State Bank of India, State Bank of Hyderabad, State Bank of Patiala, State Bank of Travancore and State Bank of Bikaner & Jaipur exceeded the deposits of Corporation Bank. Among the private sector banks, Vysya Bank with deposits of Rs.2539 crore topped the list followed by Federal Bank (Rs.1718 crore), Bank of Rajasthan (Rs.1206 crore), and South Indian Bank (Rs.1000 crore) each exceeding Rs.1000 crore mark.

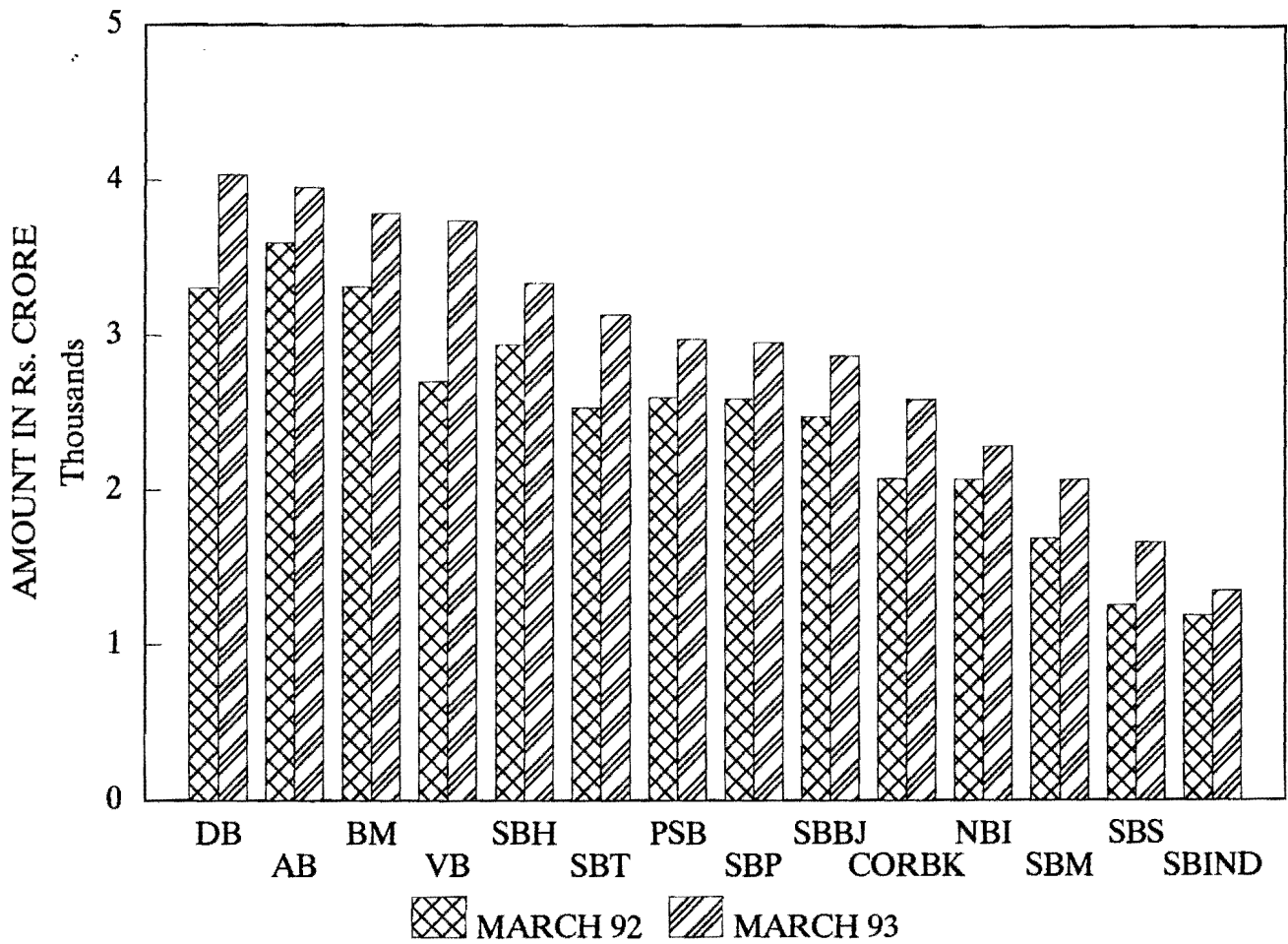
During the year 92-93, State Bank of India alone mobilised deposits to the tune of Rs.6125 crore only as against a large sum of Rs.11818 crore in the previous year. The 7 associate banks together mobilised a higher amount of Rs.3196 crore in 92-93 as against Rs.2236 crore in the previous year. The 20 nationalised banks together mobilised Rs.20469 crore during 92-93 as against Rs.19486 crore in the previous year. Among the nationalised banks 3 banks- Indian Bank, Canara Bank and Punjab National Bank - mobilised deposits exceeding Rs.2000 crore each during 92-93. In

DEPOSITS OF COMMERCIAL BANKS



SOURCE : DECCAN HERALD (BANGALORE), 30 AUGUST, 1993

DEPOSITS OF COMMERCIAL BANKS



SOURCE : DECCAN HERALD (BANGALORE), 30 AUGUST, 1993

contrast, the mobilisation of 3 banks, Bank of India, Andhra Bank, UCO Bank and New Bank of India was less than Rs.400 crore each during 92-93. Among the private sector banks, in terms of deposit mobilisation, the performance of Vysya Bank, South Indian Bank and Federal Bank has been encouraging.

A break up of deposits into term deposits, savings deposits and current deposits revealed that term deposits formed 56.1 % of the total deposits for State Bank of India and its associate banks, while for nationalised banks and for private sector banks, the share was higher at 64.8% and 67.5% respectively during the year under review. The share of savings to total deposits was the lowest for private sector banks at 17.5%. In the case of nationalised banks and State Bank and its associates it was 21% and 19.8% respectively.

In line with the lower growth in deposits, the bank credit also showed a lower growth rate of 8.1% in 92-93 as against 10.5% in the previous year. Among the bank groups, again the private sector ranked first in growth rate in credit at 26.1%. The growth rate in the previous year was 31.5%. In the case of associate banks of State Bank of India, the growth rate in advances was 17.5% as against 10.7% in 91-92. The growth rate achieved by the State Bank of India and nationalised banks were 7.6% and 6.5% respectively in 92-93 against 8.9% and 10.2% in the previous year. The nationalised bank accounted for 59.7% of the total bank credit of all the Indian scheduled commercial banks in 1992-93 as against 60.6% in the previous year. State Bank of India and its associate banks accounted for another 36.6% (36.2%). The balance 3.7% (3.2%) was accounted for by the private sector banks. Only the associate banks of State Bank of India showed higher growth rate in advances during 92-93 compared to the previous year.

The Reserve Bank's credit policy for 92-93 was largely motivated towards reviving agriculture and industrial production; encouraging exports, besides controlling inflation. The reserve requirements were brought down as a part of the phased reduction in this area, as recommended by the Narasimham Committee. The interest rates on credit were further rationalised by reducing the number of size-wise slabs from 6 to 4 and the minimum lending rate was brought down from 19% to 18%. This was further reduced to 17% with effect from March 1st 1993.

Notwithstanding the developments, the banking sector did not have perceptible leverage for significant expansion due to tight monetary situation. Correspondingly throughout the year the emphasis was on credit control and recovery management. In absolute terms, the credit expansion during the year 92-93 was smaller at Rs.12111 crore as against Rs.14230 Crore in the previous year.

The sectorwise analysis of growth rate of outstanding credit as at the end of 92-93 reveals that the private sector banks showed the highest growth rate of 26.1% as against 31.5% in the previous year, followed by State Bank of India and its associate banks at 9.3% (9.2% previous year) and nationalised banks at 6.5% (10.2%). All the associated banks of State Bank of India registered more than 11% growth rate in their advances during the year under review. However State Bank of India showed a growth of only 7.6% as against 8.9% in the previous year. Among the public sector banks, Bank of India, UCO Bank and New Bank of India registered negative growth rate in their advances during the year under review.

Credit / deposit ratio

The credit/deposit is an important indication to decide the bank's performance. It indicates the level of credit deployment by banks in relation to the deposits mobilised by them. A high credit / deposit ratio indicates that larger portion of deposits are put to use to earn maximum interest.

The average credit/deposit ratio of all the 46 Indian scheduled commercial banks declined further from 60.7% in 91-92 to 58% in 92-93. This ratio is very high for State Bank of India but it declined to 71.9% from 73.7% in the previous year. The fall in this ratio was more pronounced in the case of 20 nationalised banks which declined from 56.3% to 53.2%. While in the case of private sector banks this ratio declined fractionally from 50.8% to 50.7%, in the case of 7 associate banks of State Bank of India, it declined nominally from 61% to 59.6%.

Among the 7 associate banks of State Bank of India, the credit/deposit ratio declined in all banks except the State Bank of Travancore for which it went up from 54.7% to 59.1%. Among the 20 nationalised banks the credit/deposit ratio looked up only in the case of 5 banks - Bank of Baroda (from 55% to 56.2%), Punjab National Bank (51.4% to 54.4%), Union Bank (46.3% to 48.2%), Oriental Bank of Commerce (49% to 51.5%), and Corporation Bank (43.1% to 43.5%). The fall in this ratio was more pronounced in the case of 7 bank - UCO Bank (9.25%), Indian Overseas Bank (9.19%), Vijaya Bank (7.77%), Canara Bank (7.35%), Bank of India (6.27%), Bank of Maharashtra (6.01%) and Punjab & Sind Bank (5.40%) - each decreased by more than 5% . In the case

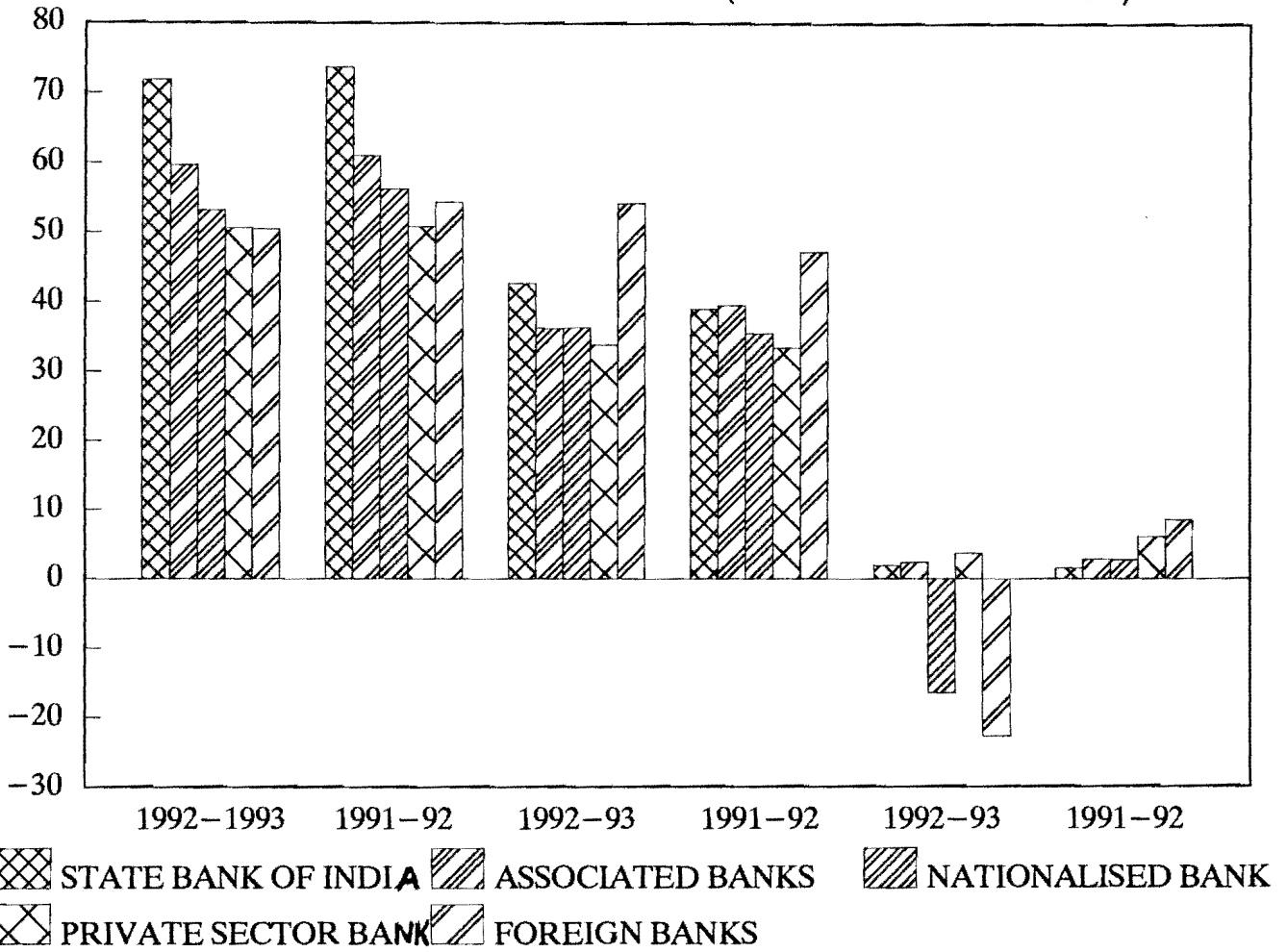
of 18 private sector banks, only 7 banks showed a rise in credit/deposit ratio during the year 92-93 and they are Vysya Bank, Federal Bank, Karnataka Bank, T.N Mercantile Bank, Lakshmi Vilas Bank, Dhanalakshmi Bank and Lord Krishna Bank.

Investments

The total investments of all the 46 Indian scheduled commercial banks increased by 17.0% to Rs.104902 crore in 1992-93 from Rs.89642 crore in the previous year. This growth rate was higher at 20.9% in the previous year. While the growth rate in investments was highest for private sector banks at 28.1% it was lowest for 20 nationalised banks at 15.6%. The growth rate for State Bank of India and its associates together was 18.5%. For State Bank of India alone the growth rate was higher at 20.7%. Among the associate banks of State Bank Of India, one bank, State Bank Of Patiala showed a negative growth rate in investments. The growth rate was less than 10% in the case of State Bank of Bikaner & Jaipur and State Bank of Indore. Among the State Bank group, State Bank of Saurashtra had the highest growth rate of 24.8%.

The income and expenditure increased at a faster rate for private sector banks in 92-93 when compared to public sector banks. For all the 46 scheduled commercial banks the profitability measured in terms of net worth and net profit to total income were negative at 34.6% and 8.8% respectively as against 10.9% and 2.5% in the previous year. In the case of State Bank and its subsidiaries while the net profit to total income increased from 1.8% in 91-92 to 2% in 92-93, the profitability measured in terms of net profit to net worth declined from 12.7% to 10.2%. For nationalised banks, both the profitability ratio were negative at 16.5% and 30.9% respectively in 92-93 as against

SCHEDULED COMMERCIAL BANKS (MAJOR FINANCIAL RATIOS)



SOURCE : ECONOMIC TIMES (BOMBAY), MARCH 23, 1994.

2.7% and 9.5% in the previous year. For the private sector banks also the net profit on total income and net profit on net worth were negative at 3.7% and 6.2% respectively as against 6.2% and 32.4% in the preceding year.

FOREIGN BANKS

Foreign banks operating in India is seen to be doing a brisk business. For the growth rate in deposits and advances achieved by them during 92-93 are substantially higher than those of State Bank of India and its associates and nationalised banks. However these growth rates are well below the growth rates of private sector banks. The total deposits of 22 foreign banks showed a higher growth rate of 23.7% as against a mere 13.2% achieved by the 46 Indian Scheduled Commercial Banks. In absolute terms, their deposits went up by Rs.4009 Crore to Rs.20896 crore in 1992-93. Of the total addition of Rs.4009 crore, ANZ Grindlays Bank alone accounted for a deposits growth of Rs.846 crore followed by Standard Chartered (Rs.761 crore), Citi Bank NA (Rs.748 crore), HongKong Bank (Rs.455 crore), Bank of America (Rs.314 crore), American Express Bank (Rs.232 crore), Deutsche Bank (Rs.146 crore), British Bank of the Middle East (Rs.118 crore) and Abu Dhabi Commercial Bank (Rs.109 crore) each one contributing more than Rs.100 crore. These 9 banks together accounted for more than 93% of the total increase in deposits. During the year Under review 4 foreign banks - ABN Amro Bank NV, Banque Indosuez, Societe Generale and Sanma Bank showed a fall in their deposits.

In terms of total deposits, Citi Bank topped the list with deposits of Rs.5009 crore in 92-93 followed by ANZ Grindlays Bank Rs.4462 crore, Standard

Chartered Bank (Rs.2323 crore), Hong Kong Bank (Rs.1872 crore), American Express Bank (Rs.1569 crore) and Bank of America (Rs.1556 crore).

The total outstanding advances as at the end of March 93 of all the 22 banks amounted to Rs.10554 crore as against Rs.9190 crore in the previous year, registering a growth rate of 14.8% in 92-93 as against 9.3% in the case of State Bank of India and its associate banks and 6.5% for nationalised banks. Here again the growth rate of private sector banks is substantially higher than the growth rate of foreign banks in 92-93. In the case of Indian Scheduled commercial banks this ratio was only 8.1%. In absolute terms 22 foreign banks together advanced Rs.1364 crore during the year under review. Of the total advances, 9 banks which advanced more than Rs.100 Crore accounted for 95.2% of the total credit given during the year under review.

In 92-93 credit grew at a slower rate than deposits. Hence the credit/deposit ratio declined from 54.4% in the previous year to 50.5% during 92-93. In the case of 10 banks -American Express Bank, Bank of Tokyo, ABN Amro Bank NV, Credit lyonmas (I), Banque Nationale De Paris, Oman International Bank, Bank of Oman, Scotra Bank, Barclays Bank plc and Sanwa Bank - credit grew at a much faster rate than their respective deposits in 92-93 pushing up the credit /deposit ratio substantially. In contrast, the deposits grew at a faster rate than their credit for Citi Bank, ANZ Grindlays Bank, Standard Chartered , Hong Kong Bank, Bank of America, British Bank of the Middle East, Deutsche Bank, Abu Dhabi Commercial Bank, Bank of Bahrain & Kuwait, Banque Indosuez, Societe Generale and Sakura Bank pushing down their respective credit/deposit ratio.

The total investment of these 22 banks showed a substantial rise of 42.3% during 92-93 from Rs.7960 Crore in 91-92 to Rs.11329 crore in 92-93. 9 banks - Standard Chartered, British Bank of Middle East, Deutsche Bank, Credit Lyonnais (I), Abu Dhabi Commercial Bank, Bank of Bahrain & Kuwait, Societe Generale, Sakura Bank and Barclays Bank - all showed more than 50% growth in their investment during 92-93. In contrast, banks which showed fall in investment in 92-93 are ABN Amro Bank NV, Oman International Bank, Bank of Oman and Banque Indosuez. The ratio of investment to deposit showed a sharp rise from 47.1% to 54.2%. The investment /deposit ratio was highest for Standard Chartered at 93.9% and lowest for Oman International Bank at 18.4%.

The net worth of all these banks went up by 95.8% to Rs.1791 crore from 915 crore in the previous year. In absolute terms the net worth went up by Rs.876 crore.

The total income of these banks showed a rise of only 6.5% at Rs.3945 crore in 92-93. This small rise in total income is attributed to the fall in the income of 4 banks.

All the foreign banks operating in India have a consistent internal policy of classifying their commercial and consumer loans and advances and full provisions for credit loans and write off have been made to conform to the prudential accounting norms prescribed by RBI for asset classification. With the result, the provisions and contingencies together increased by 64.9% to Rs.1,423 crore in 92-93 from

Rs.863 crore in the previous year. As a result all these 22 banks together incurred a net loss of Rs.899 Crore in 92-93 as against a net profit of Rs.314 crore in the preceding year. Of the 22 foreign banks as many as 14 banks showed increase in their net profit, 7 banks showed a decrease. In the case of Standard Chartered, the net loss increased further to Rs.1282 crore from Rs.159 crore in the previous year.

Recently the RBI has reported that all foreign banks operating in India, except Bank of Tokyo, had complied with the capital adequacy norms.

NOTES

1. The data in this chapter is from N.V.Venkataraman, "Struggling to meet the new Challenges", Economic Times (Bombay), March 23, 1994.

CONCLUSION AND SUGGESTIONS

The purpose of this study has been to assess the role of the Indian banking system in the socio economic field in the post nationalisation period and to evaluate its many achievements and shortcomings.

By and large, operational efficiency of banks is reflected in its profit. It is an indicator of growth, soundness and viability. In spite of manipulation under veil of secrecy, profitability of public sector banks has shown a continuously declining trend. The edifice built over two decades is crumbling and the emphasis being laid now is on viability of the system than in meeting social obligation. The focus in future will be on the quality of business rather than on volume , and through this on profits.

There is often a misconception that concept of profit is inconsistent with the role of social banking. While it may be agreed that in the present context the objective of the banking system is not merely to make profit but also to achieve the larger socio economic goal of spreading banking facilities in all parts of the country and thereby create the proper infrastructural facilities for growth the fact remains that if the bank start operating on a "no profit no loss basis" it would amount to sacrificing the generation of internal surpluses and with that the potential for growth. Social banking and profit making need not necessarily be contradictory, they can be made complementary. As a matter of fact the ability of the banking system to fulfill social objectives depends to a great extent on their commercial viability. Hence what is required of the banks is to have a positive approach to profitability planning both at the macro and micro level.

The study has shown that drastic reforms are required to revitalise the Indian banking system. The aim of the study has been not only to correct the present financial weaknesses but also to eliminate the causes which have brought about this situation. Such a programme of revitalisation of banks alone can improve their profitability and viability and give them enough resources and capacity to continue to meet their social obligations.

Some of the suggested reforms are enumerated below.

1. In the past, public sector banks concentrated mainly on funds business that is mobilisation of deposits and deployment of these resources. Steps must be taken to improve non fund based business, forex business and other fee based business and thereby achieve a large increase in other kinds of income besides interest. An increased activity in Capital Market through participation in under-writing of issues, primary issues, mergers and acquisitions etc. is also required.
2. Since the banking system as a whole is experiencing rising costs, reduction in expenditure has to be one of the primary objectives in profit planning of the bank. Cost in respect of rent, maintenance, repairs, printing and stationary, postage, telephone, advertising and publicity, staff wages etc. has to be kept in check. Cost consciousness has to be created among all concerned in the branch and if necessary cost studies should also be made branch wise.
3. Banks require greater autonomy in their day to day functioning particularly in regard to

recruitment, placement, flexibility in fixing compensation packages, career management of employees etc. In other words , banks should be free to take their own decisions in all operational matters subject to a set of agreed performance parameters at the corporate level. From the Government side all excessive controls and regulations must cease. Policies and directions must be clear cut, transparent and consistent over a long period.

4. The Government must insist on accountability by the management. For this purpose the Board of directors or the chairman must be allowed to take independent decisions.
5. The organisational structure which was hitherto based on traditional banking will have to be refashioned and cut to size keeping in view the operational efficiency and quick decision making process.
6. The RBI should consider redefining the areas covered under priority sector lending. The changes if implemented would reorient the concept of priority sector towards what it stood for when it was envisaged in 1970, that the under privileged sections of society should be given a chance to come up to the average economic standard by placing them in a distinct category vis-a-vis bank credit.
7. In order to reduce the growing proportions of non-performing assets it is imperative that lending policies should be governed and regulated solely by market conditions and the credibility of borrowers. Banks should be given sufficient discretionary powers and latitude to sanction the loan or reject the same depending on the merits of a particular case. Banks decision in such cases should be respected and no undue pressure should be brought on them.

8. Non-performing assets could also be reduced by closely monitoring the sticky advances, encouraging compromise proposals and speeding up court cases. Cases of one time settlements and out of court settlements must be processed expeditiously in the case of sticky and suit filed accounts to improve recovery.
9. The loan portfolio must be improved by establishing high standards of pre-sanction and post-sanction supervision. The banking industry will have to ensure that its staff are upgraded with all the skills of appraisal in industry and agriculture including services. Hence highly talented technical staff with skills are necessary in the management of assets portfolio in future. Greater care needs to be taken at the time of project appraisal and the banks should ensure that adequate security is provided by the borrowers at the time of disbursement of loans.
10. Although debt recovery tribunals have been established at all the major cities, to speed up the process of recovery it is essential that they be set up at all the State capitals. This would greatly expedite the disposal of bank cases. Steps should also be taken to make the tribunals really effective to assist the banks in there efforts for prompt recovery.
11. It is necessary to have systematic upgradation of technology with the introduction of computerisation at all levels of operations, while making modifications constantly on systems and procedures.
12. Total automation of at least select metropolitan branches as part of upgradation of technology for rendering better customer service is required.

13. While continuing to dedicate themselves to social banking, public sector banks could open some special branches comparable to the foreign banks to cater to the needs of rich depositors, big borrowers, including multinationals, high income group people for consumer financing, high value credit cards, electronic banking etc. and which is fully equipped with the right infrastructure including appropriate advanced technology . This would give chances to public sector banks to develop hi-tech professionalism.
14. A distinct improvement in customer service must be attempted. In fact, a basic change in the attitude of the employees towards customers needs has to be brought about. The branches should be urged to adopt a proactive approach in their dealings with customers and provide assistance to them on the basis of their felt and perceived needs. The customer redressal cell set up by the public sector banks in this context is a step in the right direction.
15. The emphasis on human resource development in public sector banks does not compare favourably with that of the foreign banks and efforts must be made to provide appropriate training to their personnel in not just the traditional functions of a commercial bank but also in the several diversified products offered by them. The carrot and stick rule should be introduced and the HRD policy must be geared towards rewarding meritorious work in an unequivocal manner.
16. If the Supervisory Board is to really fulfill its functions effectively, it should not be viewed as a policing authority but should be able to evolve sound practices in accounting, internal control and management in banks. It should have proper information and

reporting systems so that it would be able to detect the faults and lacuna in any bank and take corrective measures after taking the bank management concerned into confidence.

The Board should take corrective measures to suit the evolving situations rather than stressing only on compliance with a plethora of rules and regulations.

17. Since bank frauds in recent times has assumed ominous dimensions, it is very essential to control it. Frauds are committed not due to any lacuna in the systems and procedures of the banks but due to non-observance by the employees of the safeguards provided by the bank and hence it is necessary to ensure that systems and procedures laid down are strictly adhered to. Emphasis must be placed on the improvement in internal systems, methods and operations in banks and strengthening the internal audit and inspection systems. To discourage bank employees from committing frauds and colluding with criminal elements it is necessary that exemplary punishments are awarded to the guilty.
18. Since arrears balancing and reconciliation are potential areas of frauds, serious thought should be given to the problems of arrears of balancing of books and backlog in reconciliation of inter branch accounts in public sector banks. Failure to do so should be treated as dereliction of duty on the part of all concerned.
19. It is necessary on the part of the banks to have a close look at chronic loss incurring non-viable units and they should be made viable either through swapping , merger or closure.
20. A rational distribution of staff according to business opportunities is something which must be achieved in the present situation. Segregating the excess staff and redeploying them for deposit mobilisation, recoveries and housekeeping is required. Cooperation from

the employees will be very necessary to bring about the desired rationalisation and hence it is essential to create an awareness amongst the staff including the trade unions about the need to change and the directions in which the change is required to be brought about. There is also a need to improve working standards and discipline among the bank staff at all levels.

21. Complex accounting procedures have enabled banks to report excellent performance while concealing the reality and hence it is necessary to have greater transparency in profit and loss statements and balance sheets which would also permit timely remedial action and greater managerial accountability. In view of the importance of true and fair certification of balance sheet of banks, this area requires special attention of bank auditors particularly about reporting artificial window dressing operations.
22. It is essential to delink banking from politics. The regime of control and money regulation dependent upon government directives is something that must be done away with.
23. In a service industry like banking , the human element is the most important resource and no turn around is possible without the whole - hearted cooperation and commitment of the employees of the bank and hence a change in the work culture is required for projecting the image of the bank as a socially responsive and viable organisation.

BIBLIOGRAPHY

ABOOKS

1. Vasant Desai - Indian Banking-Nature and problems, Himalaya Publishing House, 1991.
2. Tannan M.L - Banking Law and Practice in India, Orient Law House, 1991.
3. Suneja H. R. - Practice and Law of Banking, Himalaya Publishing House, 1990.
4. Sundaram K.P.M. & Varsha P.N - Banking : Theory, Law and Practice, Sultan Chand & Sons, 1990.
5. Desai S.S.M. - Agriculture and Rural Banking in India, Himalaya Publishing House, 1990.
6. Shekhar K.C - Banking Theory and Practice, Vikas Publishing House 1991.
7. Jeevanandan C. - Practice and Law of Banking, Premier Book Company 1985.
8. Vasant Desai - Development Banking : Issue and Reforms, Himalaya Publishing House, 1988.
9. Sundaram & Varshney - Banking Theory, Law and Practice, 1990.
10. Arun Chatterjee - Legal Aspects of Bank Lending, skylark Publications, 1992.
11. Saravanel P. - Banking Theory, Law and Practice, Margam Publications, 1987.
12. Simha S.L.N - Reform of the Indian Banking System, Orient Longman, 1972.
13. Panandikar - Banking in India, Orient Longman, 1975.
14. Gadgil D.R - Planning and Economic Policy of India, Gokale Institute of Politics and Economics, 1972.
15. Iyengar H.V.R - Planning in India, Macmillan, 1970.

B NEWS PAPERS

1. Kanhaiya Singha - 24 years of bank nationalisation, Indian Express (Bombay), October 12, 1993.
2. Kurup N. K. - Private Banks-Will they change the banking scene ? Indian Express (Bombay) July 26, 1993.
3. George Mathew - Will private banks stand the test ? Indian Express (Bombay), September 13, 1993.
4. Mohan N. Patted - A rough ride a head for Indian Banks, Financial Express (Bombay), April 22, 1992.
5. Shankar .K - Priority Sector Lending-Redefinition needed, Financial Express (Bombay), September 16, 1993.
6. Saroja .S - Need for new approach in priority sector lending, Financial Express(Bombay), January 19, 1994.
7. Ushir B. D - Bank Recovery Ordinance - A hasty step ? Financial Express. (Bombay), September 8, 93
8. Subramanyam M. J - Two Years of banking reforms Financial Express, (Bombay), November 1, 1993.
9. Dhall S. C - Need for concrete steps for loan recovery, Financial Express(Bombay), June 26, 1994.
10. Chidambaram R. M - Recovery management, Financial Express (Bombay), October 29, 1993.
11. Mohan N. Patted - Putting banks back on rails, Financial Express (Bombay), February, 10, 1994.
12. Sourav Mazumdar - Nationalised banks authorised capital to be raised, Financial Express(Bombay), June, 23, 1994.
13. Khando Ballal - Asset Classification, Income Recognition and Provisioning, Financial Express (Bombay), December, 1, 1993.
14. Tiwari A. C - Our Banks: Some neglected areas and problems-1, Financial Express (Bombay), Aug, 5, 1992.
15. Narasimhan .R - Implementation of new Banking Norms, Financial Express (Bombay), January 26, 1994.
16. Bhatnagar R. G - Hitech in Indian Banking, Financial Express(Bombay),

February, 10, 1994.

17. Chidambaram R. M - Uncertainly looms over rural branches, Financial Express (Bombay), March 30, 1994.
18. Mody R. C - Proposal for new banks in the private sector, Financial Express (Bombay), Sept. 16, 1993.
19. Mahesh Jayaraman - R B I to revamp penalties for priority lending shortfall, The Economic Times (Bombay), April, 9, 1994.
20. Manali Reshamwala - Survival of the automated, The Economic Times, (Bombay), March 24, 1994.
21. Kapur V. N - Who cares for clean ups? Not banks, The Economic Times, (Bombay), March 20, 1994.
22. Aditya Samant - Low productivity is a cause for concern, The Economic Times (Bombay), July 27, 1993.
23. Venkataraman N. V - Struggling to meet the new challenges, The Economic Times (Bombay), March 23, 1994.
24. Gangadharan S. - Indian Banking: quantity sans quality, The Economic Times (Bombay), March 23, 1994.
25. Tamal Bandyopadhyay - Profit making banks ploy to get more cash, Business Standard (Calcutta), February 4, 1994.
26. Venu M. K - More autonomy for banks suggested, Business Standard, (Calcutta), February 11, 1994.
27. Amitha Sen - Mismanagement in banks exceed RBI estimate, Business Standard (Calcutta), May 31, 1992.
28. Hariharan - Private Banks - A real gold mine, Business Standard (Calcutta), December 17, 1993.
29. Mathur R. B - Banking towards competitive efficiency, Business Standard (Calcutta), November 30, 1993.
30. Madan Sabnavis - Success hinges on better recovery, Business Standard (Calcutta), June 19, 1992.
31. Gupta D. G - A total revamping of operation is the only way out, The Business and Political Observer, November 1, 1993.
32. Kharak Singh Kaira - Need to give RBI more teeth: Rangarajan, The Business and Political observer, February 11, 1994.

33. Dr. Murari Ballal N - Tragic transition from mass banking to class banking, The Independent (Bombay) Sept 20, 1992.
34. Krishna Murthy Andavolu - Frauds galore in banks, The Times of India (Bombay) March 13, 1994.
35. Rajendra Singh - Autonomy for Indian Banks, Hitwada (Nagpur), May 24, 1992.
36. Nitya Chakravorty - Govt. wants RBI nominees out of banks, The Hindustan Times (New Delhi), December 18, 1993.
37. Gupta D. G - Tasks for RBI Supervisory Board, The Hindu (Madras) September 9, 1993.
38. Raju Vernekar - And now do banking through telephone, The Observer (Bombay) February 21, 1994.
39. Rama Chandra Rao B. - Need to improve customer service by banks, The Deccan Chronicle (Hyderabad), August 30, 1993.
40. Harvir Singh - The Banks that steal a lead, Daily, (Bombay), May 30, 1993.
41. Ravi K. Wadhawan - Tackling the banking sickness, Free Press Journal, (Bombay), November 4, 1993.
42. Rao K V. - Can merger cure Banks illness? Free Press Journal, (Bombay), January 17, 1994.
43. - Banks to be allowed to enter Capital Market, Indian Express (New Delhi), September 4, 1993.
44. - Shortfall in priority sector lending, Financial Express (Bombay), August 21, 1993.
45. - Banks accused of manipulating balance sheets, Financial Express (Bombay), Oct 16, 1993.
46. - RBI Supervisory Board to be operational by year end, Financial Express (Bombay), Oct 19, 1993.
47. - Cell to probe banks frauds, Financial Express (Bombay), December 10, 1993.
48. - Banks must slim down, Financial Express (Bombay), Nov. 19, 1993.

49. - RBI tightness accounting parameters for banks, The Economic Times,(Bombay), Sept. 9, 1992.
50. - Bank frauds siphon off Rs 512 Cr, The Economic Times (Bombay), December 10,1993.
51. - Good idea, The Economic Times (Bombay),December 8, 1993.
52. - Study finds Indian banks more efficient, The Economic Times, (Bombay) November 9, 1993.
53. - Bank Fraud - The quest for an effective deterrent, Business Standard (Calcutta), December 30, 1993.
54. - Culture of non recovery in banks draws flak, The Business and Political Observer, October 26, 1993.
55. - A significant bank accord, The Business and Political Observer, November 2, 1993.
56. - Computerised banking to begin soon, The Business and Political Observer November 5, 1993.
57. - UCO bank to merge 50 loss making branches, The Business and Political Observer, December 6, 1993.
58. - Domestic banks more effective NIBM study, The Business Political Observer, November 12, 1993.
59. - 24 years on bank nationalisation, The Statesman (Calcutta), July 20, 1993.
60. - Banking on the Public, The Statesman, (Culcutta), Dec. 18, 1993.
61. - Govt criticized for bank frauds, The Statesman (Calcutta), December 10, 1993.
62. - Banking act amended - Limit on shareholders rights raised, The Times of India (Bombay), February 2, 1994.
63. - RBI norms to make banks balance sheets transparent, Nagpur Times (Nagpur), May 24, 1992.
64. - How prudential norms have hurt ? The Hindu (Madras), August 5, 1993.
65. - RBI orders 85 Bank branches closed, Deccan Herald

(Bangalore), December 10, 1993.

66. - Recruitment ban on losing banks, Telegraph (Calcutta) November 24, 1993.
67. - Indian Banks must seek level playing field, Herald (Panjim), February 8, 1994.
68. - Urgent need for reforms in banking sector, Lokmat Times (Aurangabad), January 30, 1994.

C. JOURNALS AND MAGAZINES

1. Ghosh D.N - Commercial Banking; lessons from Indian Experience, 60, J11B,45, 1985.
2. Srinivasan R. - Balancing social banking with profitability, 59 J11B, 37, 1988.
3. Dr. Thingalaya N. K - Challenges ahead, IBA Bulletin, p 44, January 1994.
4. Dahotre D. S - The future of the Indian banking system would be for the performing banks, IBA Bulletin, p 18, January 1994.
5. Rajagopal - The Priority Sector, IBA Bulletin, p 52, January 1994.
6. Mukerjee M. N - Memorandum of Understanding, IBA Bulletin, p 80, January 1994.
7. Jategaonkar - Autonomy, IBA Bulletin, p 82, January 1994.
8. Kannan .K - Supervision and Regulation, IBA Bulletin, p 60, January 1994.
9. Umesh Shenoy. G - Total Branch Automation, IBA Bulletin, p 118, January 1994.
10. Kakodkar P. G - Systems and Procedures, IBA Bulletin, p 68, January 1994.
11. Merchant P. R - Customer Service, IBA Bulletin, p 76, January 1994.
12. Narasimhan C. V - Hold Ups and other crimes in banks, (Course on Security Management in Banks-A P Police Academy), p 5, 1992.

13. Vanamalai N. T - Crimes in Banks, (Course on Security Management in Banks, A P Police Academy) 1992.
14. Niranjana Rajadhyaksha - Beefing up the base, Business World, p 120, January 26- February 28 1994.
15. - Indian Banks - Trauma of 92-93, Capital Market, p 8, Sept. 8-26, 1988.
16. - Private Sector Banking - Opening of a new chapter, Capital Market, July 5-18, 1993.

D REPORTS

1. Report of The Commission On The Financial System, (M Narasimham, Chairman) November 1991.
2. Study Group on Organisational Framework for the Implementation of Social Objective (Prof. D.R. Gadgil Chairman) 1968.
3. Committee on Branch Expansion Programmes, (F.K.F Nariman, Chairman) 1969.
4. Economic Reforms - 2 Years After and the Tasks Ahead - published by the Department of Economic Affairs, Ministry of Finance.
5. Goiporia Committee Report on Customer Service, 1992.

E ACTS

1. Banking Companies Acquisition and Transfer of Undertakings Act, 1970.
2. Banking Regulation Act, 1949.
3. Recovery of Debts due to Banks and Financial Institutions Act, 1993.
4. Reserve Bank of India Act, 1934.
5. Negotiable Instruments Act, 1881.