COMMERCIAL BANKS IN INDIA —A PERFORMANCE REVIEW

N. N. PAI

1986

Published by

THE A. D. SHROFF MEMORIAL TRUST

"Piramal Mansion," 235, Dr. D. N. Road,
BOMBAY 400 001

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THE A. D. SHROFF MEMORIAL TRUST

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OBJECTIVES

(i) Publication of one or more books in English, Hindi, and regional languages annually on some of the great builders of Indian economy aimed primarily at educating the younger generation in high standards of building the national economy as practised by those great entrepreneurs and placing the example of their lives for emulation by India's youth.

(ii) Organising one or more memorial lectures annually on subjects which were of interest to the late Mr. A. D. Shroff, namely, banking, insurance, and industrial finance, the subjects to be chosen in rotation, and the lectures to be delivered by persons eminent in these fields.

(iii) Awarding annual scholarship or scholarships to outstanding student or students in the field of management.

(iv) Instituting a prize to be known as The A. D. Shroff Memorial Prize for the student standing first in Banking at the Sydenham College of Commerce, Bombay.

(v) Doing all such acts, matters and things as are incidental or conducive to the attainment of the above aims or objects or any one or more of them; and

(vi) Without prejudice to the above charitable objects or any of them, the TRUSTEES shall have the power to spend, utilise and apply the net income and profits for the charitable object of education or such of the TRUST FUND for the TRUST FUND for the charitable object of education or such other objects of general public utility not involving the carrying on of any activity for profit as the Trustees may think proper, it being the intention of the SETTLOR that the income and/or corpus of the Trust Fund shall be utilised for all or any of the aforesaid charitable objects without any distinction as to caste, creed, or religion.

INTRODUCTION

In keeping with the objects of the A. D. Shroff Memorial Trust which was set up in 1966, an annual public lecture is arranged in Bombay on various aspects of Industrial Finance, Banking and Insurance — the subjects most dear to the late Mr. A. D. Shroff, who made a significant contribution to the economic development of the country.

In May 1986, a lecture on Banking was delivered by Mr. N. N. Pai, eminent banker, and a former Chairman of the Industrial Development Bank of India. The subject was "COMMERCIAL BANKS IN INDIA — A PERFORMANCE REVIEW".

The banking industry has undergone momentous changes and will assume critical importance in the economic development of India in the days to come. Mr. Pai has made an excellent and in-depth study of the subject. His analysis and suggestions are most constructive because they are based on his years of experience in the field of accounts and as a practical banker. All concerned would do well to ponder over the many perceptive points made by Mr. Pai in this lecture.

The Trust has great pleasure in releasing this booklet for the benefit of public education.

Bombay,
Date 14th July 1986

N. A. Palkhivala
Chairman
THE A. D. SHROFF MEMORIAL TRUST

A. D. SHROFF

(1899-1965)

A. D. Shroff's achievements in the field of business, industry and finance were many and varied. A large number of enterprises owe their origin and development to him. As an economist, his predictions have proved right over the years. Through the Forum of Free Enterprise, which he founded in 1956, as a non-political, educative organisation, he sought to educate the public on economic affairs. It was his firm conviction that a well-informed citizenry is the foundation of an enduring democracy.

George Woods, former President of the World Bank, paid the following tributes to A. D. Shroff:

> "In every age and in every society men must express anew their faith in the infinite possibilities of the human individual when he has freedom to develop his creative talents. For this is in larger part how the message of freedom is passed from generation to generation. A. D. Shroff spoke eloquently in a great tradition, and thanks to him we can be sure that other great men of India will continue to speak this message in the unknown context of our future problems."

Published by Mr. M. R. Pai, Trustee, The A. D. Shroff Memorial Trust, 'Piramal Mansion', 235 Dr. D. N. Road, Bombay 400 001. Printed by Mr. S. V. Limaye at India Printing Works, 9 Nagindas Master Road Ext. 1, Fort, Bombay 400 023.

COMMERCIAL BANKS IN INDIA —A PERFORMANCE REVIEW

By

N. N. PAI*

It is a great privilege and an honour for me to be invited to give this lecture in memory of late Mr. A. D. Shroff. Although I did not have the good fortune of knowing him personally, we all have benefited from his writings and achievements in the field of banking. Let me, therefore, request you all to join me in paying our humble tributes to late Mr. A. D. Shroff for the competent and dynamic stewardship he provided to Indian Banking Industry.

I am also grateful to the Board of Trustees of the A. D. Shroff Memorial Trust for giving me this opportunity to place before you a few of my thoughts on the rapid and dynamic changes that have taken place in the banking industry in India during the last 16 years particularly after the nationalisation of 14 major banks in July 1969 and also concerning the challenges that are facing the banking industry today.

Over the past 16 years, commercial banking in India has witnessed a sea-change, having undergone a radical transformation in its structure and organisation

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* Text of the Annual Public Lecture delivered in Bombay on 26th May, 1986 under the auspices of the A. D. Shroff Memorial Trust by an eminent Chartered Accountant and Banker, Mr. N. N. Pai, who is a former Chairman and Managing Director of the Industrial Development Bank of India and Corporation Bank.

as well as in the scope and contents of its business operations. I propose to review how this process of transformation has affected Banks' progress and dispel some of the common misconceptions about the banking industry. By virtue of their command over huge financial resources and a wide network of branches which could be further expanded to cover the rural hinterlands, banks have been assigned the role of catalysts for achieving growth accompanied by higher employment and amelioration of poverty and destitution in the country. The first step towards the realisation of this goal was the change in the style of banking operations from "wholesale" or "class banking" to "retail" or "mass" banking. This transition entailing a total reorientation of the attitude and approach has been difficult. That the banking industry has lived up to the challenges is no small credit to it.

Of late, however, it seems to have become the order of the day to blame the banking industry for each and every economic malaise facing the country. While it is universally recognised that the deployment of bank deposits should subserve the overall national interests and objectives, there are clearly areas (such as long term investment in power, transport or irrigation facilities) where commercial bank resources are not the appropriate means of financing, and even when they are so applied, the manner of their utilisation should be such as not to jeopardise the liquidity needs of banks. The financial system, with commercial banks at its Centre, has to operate within the overall investment and production priorities laid down and approved by the Government. It would be my endeavour to put before you, in as brief a manner as possible, the lending policies of banks and the role played by them in meeting the socio-economic objectives. I would also refer to some constraints under which the banks function.

The nation is now committed to agriculture and rural bias in planning for its economic growth. An increasingly larger proportion of the bank credit is being earmarked for mitigating the twin problems of unemployment and poverty confronting the country. The incidence of unemployment and under-employment is widespread specially in the rural sector which is the basic cause of poverty. The registered job seekers as at the end of 1984 were 22 million. It is further estimated that the labour force is growing at the rate of 5 million per year, of which only 0.5 million is absorbed by the organised sector. By the end of this decade, we will have to create additional job opportunities to absorb around 50 million workers.

The Government, therefore, has been laying considerable emphasis on integrated rural development and the adoption of an employment-oriented strategy. Highest priority is being given for development of labour-intensive economic activities like agriculture and animal husbandry. Massive investments are contemplated for increasing the irrigation potential, creation of rural infrastructure and provision of social services. The Government has also envisaged a much greater role for the promotion and expansion of industries in the tiny sector such as cottage and rural industries, small scale industries and industries under the self-employment schemes. These industries have a vast scope for labour absorption and at the same time they need relatively small capital investment.

For this purpose, a programme of integrated rural development incorporating the existing special development programmes was undertaken initially in 2000 development blocks, with a high incidence of unemployment, preponderance of people living below the poverty line, low agricultural productivity and having more than 20% of scheduled caste population. It has since been decided to extend this programme to all the development blocks in the country.

The Government visualises a more dynamic and purposeful role for the commercial banks in attaining the socio-economic objectives. It is inevitable that commercial banks acting as catalytic agents and mobilisers of deposits and purveyors of credit, have to play a crucial role in the successful implementation of various programmes initiated by the Government. Banks are required to formulate liberal schemes to finance priority sectors. They have been asked to adopt a flexible approach with regard to margin, security, etc., and delegate adequate powers to the Branch Managers to expedite sanctioning of loans to these sectors. Loans are now being considered on the basis of purpose and viability of the activity rather than security. In the case of technocrats and other genuine entrepreneurs, the terms regarding margins are liberally interpreted and guarantees are waived. Banks also provide loans under the Differential Rate of Interest Scheme at 4% to the weakest among the weaker sections and by 1984 nearly 4.30 million borrowal accounts belonging to this category have been provided loans to the extent of Rs. 466 crores under this scheme giving an average amount of loan of Rs. 1084 per account.

Furthermore, banks were directed to step up their priority sector lending to 33 1/3% of their total advances by March 1979 and this target was further enhanced to 40% to be achieved by 1985. This target has been surpassed by the public sector banks whose outstanding advances to the priority sectors as an March 31, 1985 aggregated to Rs. 17,971 crores, and constituted 41.3% of the total credit outstanding. Additionally, banks are required to maintain a credit deposit ratio of atleast 60% in their rural and semi-urban branches, so as to ensure that financial resources garnered from the rural hinterland are productively employed locally and not diverted to urban and metropolitan centres. Moreover, under the 20-point programme, banks have been advised to actively provide support to the implementation of the programme which aims at improving the lot of the weaker sections of the society. The modalities involved in the implementation of the priority sector lending and the 20-point programme have been spelt out and specific targets are also laid down for flow of credit to the indigent borrowers belonging to the weaker sections of society; for example, loans under the differential rate of interest scheme.

Bank Credit to Small Scale Industries :

Let me now deal specifically with bank credit for Small Scale Industries.

(i) The small-scale industry forms an integral and important part of the country's industrial structure. Today, we have nearly 15 lakh small-scale units accounting for gross value of industrial production of over Rs. 50,500 crores (of which nearly Rs. 2,380 crores is exported) and provide employment to about 90 lakh persons. This sector continued to make a significant contribution on the exports front and accounted for 21.9% of the total exports of the country in 1983-84. These units, involving as they do relatively smaller capital cost, are considered an ideal instrument for reducing regional imbalances in growth.

(ii) In recent years, there has been a phenomenal growth in the banks' coverage of small-scale units, thanks to the innovative approach made by banks in identifying prospective entrepreneurs and providing them with a package of financial and technical assistance in certain cases even without the promoters' equity. According to the published figures, the number of units financed by commercial banks increased from 2,25,000 units in December 1974 to 14,55,000 units by 1984 and the amounts advanced from Rs. 1,017 crores to Rs. 6,537 crores by December 1984.

(iii) Mention may be made here of a disquieting feature namely that the credit flows to this sector, both for investment capital and working capital, have not been as productive as expected. The unutilised capacity in this sector seems to be increasing and more and more entrepreneurs appear to be groping for solutions for a wide variety of problems.

Sickness is rampant and over 92,000 small-scale units were reported sick as of December 1984 involving a total bank credit of Rs. 879 crores. There is the serious problem of gross mismanagement of the scarce monetary resources that have been canalised into this sector. At the root of all such problems lies the absence of proper appraisal of the entrepreneur and his project, absence of financial planning and control, improper utilisation of resources, lack of proper marketing arrangements etc. Unfortunately, adequate attention has not been paid to the management of finance in the past. There is no proper financial planning or control. A number of units divert short-term bank credit for acquisition of long-term assets, as a result of which these units become sick. Banking industry is, therefore, legitimately concerned over the safety of their advances to this sector and it has become necessary for banks to monitor the assistance sanctioned to this sector to ensure that funds are not diverted for purposes not contemplated in financing plan.

(iv) Banks have also been asked to introduce a scheme of composite term loans covering both equipment finance and working capital with repayment spread over a period of 7 to 10 years or even more, for artisan and village and cottage units whose individual requirement does not exceed Rs. 25,000/-. The rate of interest on these composite loans would be 12 per cent.

Agricultural Credit :

(i) Banks have been advised to participate effectively in the Integrated Rural Development

Programme, presently being implemented in over 5000 blocks, all over the country. The main thrust of the programme is on provision of full employment and better standard of living to the rural poor through productive investments. Banks are asked to ensure that atleast 25% of their total advances go to the weaker sections comprising of small and marginal farmers, village artisans, cottage industries, scheduled castes/scheduled tribes and to DRI and IRDP Programmes.

(ii) Advances made by the commercial banks to agriculture amounted to Rs. 8,932 crores in December 1985. The recovery rate of these advances has been around 50% of demand. The high overdues in respect of agricultural loans have arisen from poor loan appraisal, absence of post-loan supervision, under-financing of investments forcing the borrowers to seek high-cost supplementary loans from the informal sector, failure to reschedule loans in years of natural calamities and prescribing irrationally short loan maturities which push the burden of loan servicing beyond the borrowers' repaying capacity. In short, the banks are themselves responsible for creating overdues to some extent. This is not to underplay the wilful default induced in no small measure by political interventions especially on the eve of elections.

(iii) Why have rising amount of loans and overdues not created pressures on banks' liquidity and their ability to give new loans for priority sectors? The answer is that fortunately banks' deposits in rural and semi-urban branches have risen faster than their agricultural overdues. For instance, commercial banks' overdues in respect of direct agricultural advances increased from Rs. 279.9 crores in 1976-77 to Rs. 1351.3 crores by 1983-84. During the same period, however, the deposits held in their rural and semi-urban branches increased from Rs. 5,946 crores to Rs. 23,326 crores.

The Commercial banks have responded well to the new responsibilities devolving on them. In tune with the changing priorities and social needs, they have been making sincere, vigorous and energetic efforts in meeting the expanding credit needs of agriculture, small-scale industries and other indigent borrowers belonging to the weaker sections of the society such as retail traders, transport operators, landless labourers, artisans and scheduled castes and scheduled tribes. Reflecting these efforts, credit extended by commercial banks to these sectors increased from Rs. 504 crores in June 1969 to Rs. 20,991 crores in December 1985 i.e. more than a forty-one fold increase over a decade and a half.

Given the importance of the priority sectors and keeping in view the fact that these sectors were neglected by the banks earlier, it is creditable that the banks have been able to accelerate the pace of credit flow to the priority sectors. In fact, when we realise the tasks involved in extending productive lending to priority sectors, we become really appreciative of the yeoman service that the banking sector has rendered to the society. Since the number of loan cases that have to be handled for increasing the flow of assistance to priority sector is very large, the efforts that banks have to put in in extending credit to these sectors become very stupendous.

Bank Credit to Industry :

While being appreciative of the tremendous achievements of the banking sector in lending to priority sectors, one also needs to ponder over the question whether some other sectors which are equally productive and which, perhaps, play much larger role in catalysing growth in the economy have been relatively neglected by the banking industry. As any one would agree, the industrial sector is expected to play the lead role in the growth of the economy. The history of the economic development pattern of the now developed countries shows that industry was the most dynamic sector of these nations. Unless industry grows at a rapid rate, the economy also cannot grow rapidly in view of the close links that industry has with other productive sectors. Within the industrial sector again, it is the large and medium scale units that play a catalytic role in accelerating the growth process. A close study of the growth pattern of Japanese economy or for that matter any other developed country indicates that the small sector grows mainly on account of the intermediate goods supply and other services needed by the large sector. Hence the growth of the medium and large industry has to be encouraged in an integrated manner if the economy is to grow at a satisfactory rate.

The medium and large industry sector requires finance as a major input for its growth. With the emergence of the large number of All-India and State level development banks, the medium and large industry does not find it difficult to get term loans for financing its projects. But the same cannot be said with equal confidence about commercial bank credit. By end December 1985 commercial bank advances to medium and large industry amounted to Rs. 17,912 crores which accounted for about 33.64% of the gross bank credit and 38% of the non-food gross bank credit. The proportion of bank credit to medium and large industries, which was about 67% in 1969, has been declining continuously since then. At present the share of medium and large industry in gross bank credit is hardly 34%. Thus, the reorientation of lending priorities has meant sharp decline in bank credit to large and medium industry, which, as stated earlier, is the lead (dynamic) sector of the economy. While the share of this sector in bank credit does not appear small in relation to its contribution to Gross Domestic Product, the disturbing fact is that the growth rate of industrial output has slackened since 1970. Industry has never grown as rapidly as it did during the Third Plan period — during 1961-66.

Branch Expansion :

(i) During the last 16 years after the nationalisation of 14 major commercial banks in the country, 43,123 new bank offices were opened throughout the country raising the total number of functioning offices from 8,262 in June 1969 to 51,385 at the end of June 1985. Out of the new offices opened, over 65% were located in centres where there had previously been no commercial bank office. The average population per bank office has declined from 65,000 in June 1969 to about 13,300 in June

1985. The branch licensing policy laid emphasis on the expansion of banking facilities in deficit areas, reduction of inter-state and interdistrict disparities and on rural development. It is expected that the pace of branch expansion will continue to be maintained in order to extend banking facilities to every nook and corner of the country. It hardly needs to be emphasised that the rapid increase in the number of branches, particularly in the rural areas, throws up a Challenge to the Indian banking system to devise appropriate ways of recruitment, training and deployment of personnel for manning these banks. The bank managements are seized of this responsibility and all-out efforts are being made to gear up the machinery to this end.

(ii) Realising the problems of the banking industry, Reserve Bank has now decided to pursue a cautious approach and consolidate the gains already achieved to ensure that the existing branches improve the quality of lending and loan recoveries. Under the new branch licensing policy, new branches will be permitted on a selective basis taking into account the need for credit facilities and adequate potential for banking business. Thus, for the first time Reserve Bank has accepted the relevance of the concept of financial viability to its branch expansion policy.

Credit Policy :

(i) Let me now turn to the credit policy relating to working capital finance. The measure of strength acquired by the country's economy during the seventies has been somewhat shaken by the increase in price levels witnessed since March 1979. I would not go into any analysis of the causes of inflation or what needs to be done to fight it. These are best left to the judgement of the fiscal and monetary authorities. As the price and production trends both showed a deterioration, the need for further credit restraint became evident. In the course of the past few years, quantitative and qualitative credit control policies, structural changes affecting the cost of credit and steps towards contracting banks' access to Reserve Bank credit were all enforced. The controls were applied with a degree of selectivity in order to provide some protection to the priority sectors and to meet the genuine needs of production, investment and employment generation.

(ii) By and large the credit policy has remained restrictive during the decade of 1970s as also thereafter although this period has witnessed short periods of relaxation of restrictions on credit. At times when the policy became very restrictive, the sector that suffered the most from cut back in bank credit was the medium and large industry sector. Quite often, credit is not available even when it is needed for stepping up output of existing units. Worse is the fate of new units which are self-financed or financed with the term loans from development banks. Banks are not willing to extend credit to such new units on the plea that they are subject to rigours of the restrictive credit policy. Thus the restrictive credit policy often results in restraining growth in output and thereby adds fuel to the fire of inflation. Even the existing units do not get adequate credit based on the real assessment of credit requirements. Quite often, industrial borrowers need larger credit facilities, mainly because of the steep rise in the prices of raw materials like steel, coal, metals, petroleum products, etc., on account of the taxes levied by the Government and also the Government's decision to increase their prices. Several industries had to meet the burden of heavy back wages to labour as a result of wage settlement with the Unions. Such increases in costs are not offset by the rise in the prices of finished goods, some of which are controlled by the Government. The credit limits, therefore, will have to be linked to these factors; otherwise it would lead to restrictions on output, which is not in the interest of economy, whether short-term or long-term. It would cause greater damage when credit policy restricts output of capital goods and thus puts a brake on the growth of capital formation in the economy.

(iii) At the same time, if interpretation and implementation of credit policy are totally left to the discretion of individual branch managers who number over 51,385 today, the end-result could be disastrous. This is the dilemma which the banking industry is yet to resolve.

If past efforts to keep inflation in check have failed, it was not due to defective policies, but mainly due to the lack of financial discipline shown by some segments of the economy. All the sectors of the economy will have to function in unison, observing a measure of discipline. Trade and industry will have to practise a greater measure of financial discipline and make a judicious use of the scarce bank finance. In other words, they will have to rely more on their internal resources and adhere to more efficient inventory management, abiding by the Tandon Committee norms and filing of quarterly returns. The Bank Managers will have to play a greater role in inculcating the required sense of financial discipline. Wage earners will have to show restraint in demands for increase in wages and organisations will have to practise austerity and curb wasteful expenditure. Therefore, there is clearly a need to review the mechanism of cash credit.

Physical and Credit Planning :

For the last 5-6 years, the Reserve Bank of India and the Planning Commission have been thinking actively on co-ordinating credit policies and plan policies. The co-ordination that is yet to be achieved is between the physical planning (or any other planning that envisages growth in productive capacity) and credit planning (which envisages credit for productive purposes). Despite the fact that this dialogue has been going on for so many years, no tangible guidelines have yet emerged. Even the recent plan documents do not provide any evidence that a serious effort has been put into this exercise and that private sector's credit needs are going to be taken care of through a suitable plan co-ordinating mechanism.

Aggregative Credit Policy :

The credit policy pursued by Reserve Bank of India is based on aggregative exercises without special attention to such important considerations as specific credit requirements of particular industries and industrial units. The credit policy is based on such aggregative indicators as the anticipated growth in bank credit, Government's deficit finances and the rate of inflation observed in the past. Based on these parameters, the Reserve Bank of India fixes projected growth rate for money supply. Since the requirements of the Government and priority sectors are regarded as supreme, the credit availability to the medium and large industry becomes a residual item. Whenever the growth in money supply is to be curtailed as per Reserve Bank's assessment and the Government's requirements of funds are relatively large, credit availability to the medium and large industry is curtailed. But such policies, if they result in shortage of credit to medium and large industry, would affect productive sectors directly. I submit that the credit requirements should be arrived at by keeping in mind the needs of different industries. If there is a high rate of inflation in the economy, it is quite often noted that the price rise is not evenly spread in respect of all commodities. During any given period, the price rise of certain commodities is much higher than that of others. If we are able to identify in advance the goods in respect of which the price rise is relatively high, deliberate attempt has to be made to step up their output. If larger credit is needed for increasing their production, it should be made available. This suggestion thus implies a shift from macro to micro planning based on output and growth of individual sectors. The Reserve Bank of India would be able to undertake such an exercise based on information it already has. The studies published by Reserve Bank of India on Company Finance would be of great use in identifying the credit requirements of different industries. Credit policy can be expected to play a useful role only if it has closer link with output and growth.

Credit Authorisation Scheme (CAS) :

The Reserve Bank of India on the basis of recommendations of Marathe Committee evolved its so-called 'fast track' approach. This approach visualises quick sanction of limits upto 50% of the credit requirements of the unit by the bank itself before it approaches the Reserve Bank of India. But before granting such high credit limits, the bank is expected to undertake a detailed analysis for assessing the credit requirements of a unit. But it is now accepted by the Reserve Bank of India that the 'fast track' system has not helped the industry, partly because of the comprehensive credit discipline stipulation under it and the delays involved in post-disbursal scrutiny by the Reserve Bank of India. The banks are not willing to take the risk involved in such an exercise. There are several areas in respect of which the bank officials are expected to ascertain the genuineness of the need for the extra bank credit. Some of the bank officials are reportedly not willing to take responsibility in these matters and, as a result, the fast track method has not got off the ground at all. The credit authorisation scheme has been liberalised recently by raising the cut-off point for working capital limit from Rs. 4 crores to 6 crores, and to Rs. 7 crores in the case of manufacturers and trade-exporters. The R.B.I. Governor while addressing the annual general meeting of the Association of the Indian Engineering Industry recently has gone on record to doing away with CAS if large industrial borrowers agreed to file their quarterly returns in time and abstained from misusing credit limits. The liberalisation reflects the decision of the Reserve Bank of India to let the commercial banks play their role in disciplining their borrowers and monitoring their operations. The commercial banks, therefore, need to streamline their administrative machinery and assume responsibility involved in this process. Unless this is done, the industry would continue to suffer from paucity of credit.

Co-ordination Between Banks and Other Financial Institutions :

(i) There is also absence of a close co-ordination between the banks and other financial institutions. This lack of co-ordination is conspicuous in tackling of the credit requirements of healthy as well as sick units. The banking sector considers its assessment to be more accurate than that of other institutions. In this respect one can safely say that the exercises undertaken by the term-lending institutions are certainly more scientific and rigorous than the exercises undertaken by the banks. The institutions are in an advantageous position in these exercises in view of the fact that they have in their employment, people suitably qualified in technical, financial and other areas which a large number of banks may not have. Even so, banks do not accept the assessments made by the term-lending institutions in regard to the working capital requirements of units assisted by the term-lending institutions. For an effective functioning of the institutional structure, it is desirable that the banks and the financial institutions make the assessment in regard to working capital requirements of new units jointly rather than withhold grant of credit until bank's own exercises are complete. Alternatively, banks could sanction credit limits based on term-lending institutions' assessment and exercise control at the utilisation stage so that excess credit is not utilised by the units.

(ii) The problems become really serious when rehabilitation packages have to be worked out. The term-lending institutions find it difficult to carry commercial banks along with them as each commercial bank adopts its own approach despite the fact that the term-lending institutions undertake a thorough indepth study of the sick unit before they present the rehabilitation package to the commercial banks for participation. Quite often the banks do not grant their concurrence to a package evolved after long and detailed study. The problem becomes more acute when one of the banks refuses to fall in line with the others involved in rehabilitating a unit. Therefore, the problem of sickness cannot be tackled effectively until the banks also co-operate effectively in extending credit for rehabilitating it.

Deterioration in Quality :

(i) A fall-out of the advent of social banking and the consequent phenomenal increase in the number of bank branches is a marked deterioration in the quality of banking service. Several factors have contributed to this phenomenon, chief among them being rapid expansion in the volume and diversity of business, shortage of trained staff and lack of motivation among them.

(ii) The dictum "Customer is the King" prompts all productive activity in a *laisser-faire* economy. This dictum should be adhered to in the banking industry as well, in view of the greater direct personal interaction between banks and their customers. Unfortunately, customer-service today is characterised by delays, negligence, errors of omission/commission, indifference and impolite behaviours. Bad house-keeping, considerable delays in balancing of books and reconciliation of inter-bank transactions, have been a temptation to the unscrupulous bank employees to defraud the banks.

(iii) Decline in quality of lending coupled with poor post-lending follow-up has blocked up large funds in sick industrial units. This decline in operational efficiency and the burden of social banking have jointly eroded the profits of banks. Initially, bankers in their zeal to achieve quantitative targets ignored these requirements and accepted the quality deterioration as an inevitable consequence of mass social banking. Fortunately, the realisation has now dawned upon all concerned both at the ministerial levels in the Government and the bank management that despite their social slant, banks have necessarily to function as commercial enterprises. Banks should, therefore, take immediate steps to stem the rot that has set in and restore the high standards Indian banking was associated with. I have no doubt that hard decisions backed by resoluteness of purpose and political will, will yield positive results in a short time.

Genesis of Qualitative Deterioration :

(i) The genesis of all these problems lies in the pace of change experienced by banks. The quantitative and geographical growth in banking, to say the least, was explosive. As mentioned earlier, the number of branches increased from 8,262 in July 1969 to 51,385 by June 1985 — an achievement which no other country in the world could boast of. Total deposits increased from Rs. 3,599 crores to Rs. 76,373 crores during the same period, while the number of individual deposit accounts also increased from 38 million to 145 million. Banking system had not been geared to weather this fast pace of change. Banks should now pause and consolidate their quantitative gains. They should for the next few years target for a steady growth and improved quality of banking services.

(ii) On the advice of the Government, banks have initiated some measures to improve customer services. Apart from mechanisation of certain banking operations and enforcement of discipline among bank staff, banks have increased the frequency of courier services and improved the efficiency of despatch departments. Customer service cells have also been set up in metropolitan centres to attend to customers' complaints promptly. The Union Finance Ministry has recently commissioned the National Council of Applied Economic Research to make a study of the impact of the recent measures taken by banks to improve customer services.

(iii) The customers' discontent has further escalated due to the recent hike in service charges effected by banks without any perceptible improvement in customer service. Banks have sought to justify higher service charges on the ground that huge investments are being made by them in mechanisation of operations, which would ultimately improve customer services. While there is no denying the prerogative of the banks to determine the quantum of service charges leviable for various banking services offered by them, the banks should exercise moderation lest they be accused of profiteering in a monopolistic situation.

Human Resources Development :

(i) The human resource development problem in the banking sector needs to be looked into from several angles viz. education, employee attitudes, working conditions and promotional opportunities. In regard to education, I must say that the problem has more or less been left largely untouched. Today, the banking sector employs 6.42 lakh employees and is said to be one of the most important sectors providing high-wage employment opportunities. And yet hardly any University degree is being considered desirable in the field of banking. Even if we exclude the supporting staff comprising Peons, Typists, etc., the clerical and officer staff is recruited without insisting on any special banking qualification other than a University degree in any one of the numerous subjects. All the newly recruited staff are trained by banks on the desk. A number of banks have also attempted to provide training facilities which, by any standards, are highly inadequate for the type of jobs that are being performed these days by the banks and the size of skilled man-power that they have on their rolls. If we need trained engineers, doctors and scientists for specific jobs, why should we not have specially trained banking staff having a degree in banking?

(ii) Given the replacement requirements for retiring persons and the growth of banking industry, we need to recruit every year about 20,000 to 25,000 employees as clerical and officer staff.

Why should the banks be burdened with the responsibility of training such new entrants in the basic rudiments of banking for equipping them to handle their desks? Why should there be waste of national resources on this scale first by producing graduates in all sorts of subjects like Sanskrit, English, regional languages, different science subjects like geology, chemistry, bio-chemistry etc. and waste all this training when such persons have to join the banks? Why not utilise the same four or five years of college education for providing banking education so that when such trained persons join the banks, they become productive almost from the first day of their joining the banking industry? An assured better-paid employment opportunity would certainly act as a great incentive for vast number of job aspirants to take up University education in the field of banking.

(iii) It is in this area of education that the National Institute of Bank Management (NIBM), which was established soon after nationalisation of banks as the apex training institution in the field of banking, should give an effective leadership to the banking industry. NIBM should induce Universities and colleges to start special graduate courses in the field of banking. As regards formulation of syllabus, preparation of necessary teaching material etc., the NIBM should become a think tank and leader. Since NIBM is backed by the most powerful financial institutions of the country viz., the Reserve Bank of India, the entire commercial banking industry as well as the development banks, it should not find it difficult to exercise its influence in initiating graduate courses in the field of banking. Eventually, NIBM should emerge as an apex institution for providing both post-graduate training and research activity in the field of banking.

(iv) Improvement in quality of banking, be it in the area of customer service, house-keeping or lending, would essentially require enlisting whole-hearted involvement and support of its employees. Any steps evolved in isolation from this fundamental doctrine are bound to fail.

(v) Today, a bank employee is better educated and better informed than in the past. This has given rise to increasing aspirations in him, both in professional and personal life. He is temperamentally less docile and more expressive in his dissent towards any system that does not cater to his expectations. Bank managements have failed to realise this facet of personnel management. A better educated bank employee of today continues to be burdened with repetitive and monotonous clerical work devoid of any scope for initiative and innovativeness. Consequently, a bank employee of today has no sense of involvement or pride in his job which characterised bankers of the past, as is reflected in the deterioration of customer service and bad house-keeping. No serious attempt has been made to enrich the job satisfaction at the lowest level. Computerisation/mechanisation of routine banking operations would contribute towards job enrichment and satisfaction and also relieve them from the skull-drudgery of routine monotonous operations. The bank employees would welcome such attempts in job enrichment and their present hostility to computerisation would give way to co-operation and ready acceptability.

(vi) Bank employees should also be provided with a better physical environment to work in. Claustrophobic offices impede efficient and peaceful working. General decline in discipline and work ethos that one notices today in all spheres of national life also finds its reflection in the defiant stance and indiscipline of the bank employees.

(vii) Today, the management and employees view each other with distrust. This leads to a continuous confrontation resulting in disruption in banking services. Senior Managers, at all levels, should reach out and personally interact with the employees. Free and frank exchanges of views would gradually create mutual trust and respect and establish a spirit of camaraderie. At the same time, the management should not hesitate to enforce discipline among bank staff.

Management of Change :

(i) Today, we find "winds of change" blowing from the North. This is a welcome development. In such a dynamic environment, it is imperative that the banks respond to these changes quickly. The banks necessarily, therefore, have to initiate policy and system changes in their organisations, to ensure quick responses on their part to the changing times and expectations.

(ii) There is no denying the fact that "Management of Change" is easier said than done. It calls for utmost resourcefulness, tact, perseverence and patience. This task can be made easier by infusion of fresh blood in the organisation, by a system of horizontal transfers/promotions among the various Public Sector Banks. Such a system of horizontal transfers would relieve the Chairman/Managing Director from the fetters of work culture/system in which he has been working and relieved of these handicaps, he can adopt a more bold and innovative approach in his new environment.

(iii) One more step in this direction would be to extend the tenure of appointment of the Chairman/Managing Director from the present 3 years to 5 years. It should, in all fairness to the Chairman of the banks, be appreciated that a period of 3 years, is too short for familiarisation with the new organisation, its people, work-culture and systems and thereafter, to initiate and implement changes. Today, this short span permits them to make only cosmetic changes and tinker with the existing system. Therefore, the Chief Executive of the bank should be granted a longer time span of at least 5 years, to enable him to execute this task. This extended tenure of 5 years would be in line with that generally approved by the Central Government to the Chief Executives in the Private Corporate Sector.

Industrial Sickness :

(i) Another area of considerable national import, is the problem of salvaging the substantial resources blocked up in sick industrial units. This has been a subject of repeated discussion but no plausible solution seems to have emerged. In the meantime, the number of units and amount of funds blocked up continue to grow at an alarming rate. Rehabilitation of these sick units and salvaging of scarce national resources locked up therein should be accorded national priority.

(ii) According to data on sick industry published by R.B.I. as at the end of December, 1984, there were 545 large-scale, 1,281 medium-scale and 91,545 small-scale sick units, involving Rs. 2,330.12 crores, Rs. 428.58 crores and Rs. 879.69 crores respectively. The total funds blocked up in sick units were Rs.

3,638.39 crores forming 8% of the total bank credit or 14% of the total credit to industrial sector. Of the total of 93,371 sick units in the country, as many as 75,860 are non-viable, while 2,712 have been put through various nursing programmes. The total funds blocked up in sick units in 1979 was only Rs. 1,623 crores. The increase between 1979 and 1984 has been of the order of 124%.

(iii) No doubt, industrial sickness is a concommitant of the very process of industrialisation, in which vigorous and well-managed units grow, while poorly conceived, inefficient and marginal units languish and gradually disappear from the industrial scene. However, in developing countries where capital is scarce and alternative employment opportunities are relatively scarce, industrial sickness is a matter of serious concern and more so, if the sickness seems to be growing.

(iv) Good management is a *sine qua non* for the effective functioning of an industrial unit. Though causes of industrial sickness have been varied, more often than not, failure of the management to anticipate changes in market, control costs and improve methods of production by continuous updating of production, technology and facilities, have converted an otherwise healthy unit into a sick one. Instances are not few where sickness has been brought about by deliberate acts of financial misfeasance by the management. In such cases, banks should not shy away from precipitating a change in management, when such a change is exigent for rehabilitation of the sick units. Banks and institutions should establish a special cadre of professional managers, who could be deputed on "turn-around missions". Institutions and banks have amply demonstrated their capacity to 'turn-around' sick industrial units, as in the case of Kamani Engineering Ltd. and India Cements Ltd. Banks should no longer continue to play a role of passive purveyors of credit and be content with receiving periodical statistical information from the units financed. They should play a more active role and pay more attention to the qualitative aspects of production and marketing strategies than merely in perusal of historical financial data on operations.

(v) It is a common complaint that many a rehabilitation package has failed to yield results due to considerable time-lag between its conception and implementation. The time-lags are often the result of delay in emergence of a consensus on package and procedural demands of the bureaucracy. The situation demands immediate decision-making and cannot afford the luxury of procrastination till a consensus emerges.

(vi) Individual banks have developed a particular industry specialisation by virtue of a predominance of borrower units of the particular industry in their loan portfolio. This industry specialisation can be put to good use for revival of sick units of the particular industry, be it financed by the concerned banks themselves or otherwise. The commercial banks should, therefore, consider swapping of sick industrial units to realign them to their respective areas of expertise. Historically, banks in Germany did attain such specialisation upto the First World War and thereby contributed to the rapid industrial growth. The proposed specialisation in India would not only contribute to averting industrial sickness, but also to effect economy in the banks' costs of appraising new proposals. To encourage this process and induce a fellow banker to this concept, swapping of units may be accompanied by an offer of a financial discount, the quantum of which would be left to the perception of risk involved and commercial bargaining.

(vii) Units which have been identified as unviable should be closed down. We cannot afford the luxury of blocking of scarce national assets in such unviable units at the cost of other efficient and economic units. There is a fallacious assumption that finance is the panacea for industrial sickness. It is pointless to continue to pour money into this bottomless pit and pump in good money after bad. Though social compulsions may call for sustaining sick units, banks should foreclose their mortgages to recover their dues where the units are found irretrievably sick. The Government should in such cases adopt a pragmatic attitude and not be swayed by the pressure of labour unions or the electoral implications of such a move. Social considerations demand rehabilitation of workers displaced from such units and not the parasitic existence of these unviable units.

(viii) Rescheduling of past statutory dues with a reduction of upto 2% in interest on term loans and waiver of penal interest applied to Cash Credit are among the new measures being taken by the Reserve Bank of India to rehabilitate sick industrial units.

(ix) Economic criteria should be ruthlessly applied in identifying units which can be rehabilitated within a specific time frame. The decision to nurse a sick unit should be taken purely on professional and economic considerations of viability. While social considerations cannot be ignored, they cannot be the sole guiding factor.

Profitability :

(i) The declining profitability of the banking industry has been causing serious concern in several quarters. Banks are essentially commercial organisations and like any such organisation, they must give a fair return on capital after providing adequately for business risks. No doubt, banks have to discharge their corporate citizen's responsibility by fulfilling social obligations enjoined on them. At the same time, they can ill-afford to ignore their commercial viability. Banks are highly sensitive institutions open to public scrutiny and as such, they must continuously ensure their profitability, which is essential for their growth and viability as also for infusing public confidence.

(ii) Restrictions on the bank's freedom to optimise returns from the investment of their resources also limit their capacity to generate income. In our country, the amount of funds banks can deploy at commercial rates is getting more and more restricted due to the increasing Statutory Liquidity Ratio and Cash Reserve requirements. Bank funds presently impounded by way of statutory cash and liquidity requirements account for as much as 56% of their new resources. The yield on these pre-empted funds is well below the average cost of deposits. Even after meeting the high statutory requirements, banks do not have complete freedom to deploy their residual funds in a most profitable manner, since they have been called upon to meet other national plan priorities and social objectives. They have to meet the credit demands of priority and neglected sectors and food and other public procurement operations as also extend credit for exports and make advances under DIR Scheme, etc. All these demands from the priority and preferred sectors take a major slice of the loanable funds the yield on which is not economic. The percentage of deposits available for reasonably profitable investment in non-priority sector advances is barely 20. The net result is that on every Rs. 100 of deposits mobilised, the banking system, loses almost a rupee. Today, profits of the banking system are dependent on the income from ancillary business. The low service charges which prevailed till recently without relevance to the wages and establishment expenses or overhead costs, ever-spiralling D.A. to employees, higher deployment of funds in low-yielding priority sectors, massive branch expansion programme, all portend further decline in profitability. While it is recognised that profitability of the banks has to be subordinated to their obligations to subserve national policies, it is submitted that so long as the banking industry is given the character of a commercial enterprise, its viability cannot be ignored in the interest of the maintenance of the pace of progress of the economy.

(iii) I have referred earlier to the eroding margins of banks arising from concessional lending to priority sectors and low returns from Statutory Liquidity Ratio and Cash Reserve requirements. In part, the eroding margins have also stemmed from stagnant deposit and lending rates. While I do not wish to deal with this subject at length, I feel that there is need to review whether banks' lending and deposit rates are in tune with inflation, risk and the real opportunity cost of capital. A reason commonly adduced by banks for poor loan monitoring, especially in the priority sectors, is that their margins are inadequate to enable them to appoint adequate staff for monitoring millions of small loans. In my view, the time has come to reflect on whether the nation should continue to support cheap credit policy when it produces weak impact on growth. If slightly higher lending rates can enable banks to appoint additional staff to optimise the impact of loans on output, income and employment, it may be desirable to raise the lending rates.

Recommendations of The Chakravarty Committee :

(i) Before I conclude, let me discuss briefly the likely impact of some of the basic changes that may be brought about in the over-all monetary and banking system of the country if the recommendations of Sukhamoy Chakravarty Committee are implemented by Reserve Bank of India and Government of India. The recommendations of the Committee on the interest rate regime are highly imaginative and should go a long way in resolving some of the major difficulties faced by the banks all these years. The Committee has suggested that deposit rates as well as the lending rates of banks should be linked to the expected long-term inflation rate in such a way that banks earn a reasonable margin. The minimum lending rate of the banks would be fixed, as per these recommendations, in such a way that banks earn a margin of 3 percentage points over the maximum interest rate on term deposits. Since banks would be earning margins higher than 3 percentage points on other lendings, the profitability of the banks would get fully protected. If long-term inflation rate remains around 8% the minimum lending rate of banks would be at 13% maximum deposit rate at 10% and the other lending rates may be expected to be in the range of 15% to 16%. While this would be a welcome recommendation from the point of view of the banks, it should be noted that the lending rates of banks would tend to be inflexible even in periods of high short-term inflation, as the lending rates, as per Chakravarty Committee, would get fixed with reference to long-term inflation rate. In short periods of high inflation, banks would find it difficult to charge higher rates to price out some of the speculative borrowers. Since Chakravarty Committee is, in any way, in favour of giving greater degree of freedom to banks to vary their lending rates, it would be desirable to make the interest rate flexible enough to respond to high inflation rates prevailing during short periods. During the normal periods, however, the lending rate structure, as suggested by the Chakravarty Committee, should continue to hold good and thereby remain as the base level structure below which interest rates would not decline.

(ii) Another recommendation made by the Chakravarty Committee which is aimed at minimising Government borrowings from

Reserve Bank of India appears to be, *prima facie,* welcome as it would help in curbing growth in money supply. But if the borrowings from Reserve Bank of India are substantially curtailed and the resources are going to be raised from the household sector directly, over and above those raised through National Savings Certificates etc., such a measure would have far-reaching implications for the banking system. The data made available by Reserve Bank of India indicate that household sector is the largest single source of additions to commercial bank deposits (accounting for over 75% of the additional deposits). If Government starts tapping the household sector directly in a big way for additional funds, which it has now been getting from Reserve Bank of India, the deposit growth rate of banks would fall sharply. It should be noted that the growth rate in deposits of banks fell sharply from an annual average of 21.9% during the five year period 1976-80 to 17.5% in the next five year period of 1981-85. If this particular recommendation of the Chakravarty Committee is accepted and implemented, the bank deposit growth rate would fall much more sharply to say 8% to 9% in the immediate future. The implications of such a development would be quite adverse not only to the organised trade and industry but also to all the priority sectors to whom a sizeable chunk of incremental bank credit is being advanced.

(iii) The Chakravarty Committee has also recommended that considerable degree of competition should be introduced in the banking system. Apparently this is a welcome suggestion as we all expect that competition would bring about the desirable changes in the form of improved efficiency, better customer service and possibly more competitive interest rates. But I am not quite enthusiastic at least about the interest rate competition among banks. The social and cultural factors that have influenced the growth of the banking industry after nationalisation do not appear to be conducive for introducing a high degree of price competition among banks as we have today in the Western World. The recent experiment in interest rate freedom given to banks in respect of deposits of upto one year maturity has proved that banks are not attuned or geared to price competition. On my part, I would prefer greater competition among banks in the quality of service they render to their customers. It is in the overall interest of banks at least in the next few years, to have administratively determined rates for most of the important categories of depositors and borrowers and introduce interest rate competition in a gradual way over the next decade or so.

Facing The Challenges :

Social banking in India does not find its parallel anywhere else in the world, either in its scale or nature of operations. Banks' performance in this area has been no doubt creditable. Banks are implementing with full vigour programmes and measures indicated by the Government and the Reserve Bank of India. They are doing this despite the erosion in their profitability. Faced with the various constraints enumerated earlier and following the policy designs of the Government and the Reserve Bank of India, the banks have done commendably well in meeting the socio-economic objectives. The next few years are going to be of crucial importance to the banks. They are likely to throw up many more challenges. There is no doubt that banks will accept these challenges in their true enterprising spirits.

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