QUALITY IN BANKING

N. VAGHUL

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Published By

THE A. D. SHROFF MEMORIAL TRUST
"PIRAMAL MANSION," 235, DR. D. N. ROAD
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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 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.

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 large 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."

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INTRODUCTION

The A. D. Shroff Memorial Trust arranges every year a public lecture, by rotation, on Banking, Insurance and Industrial Finance. The text is published later for the benefit of a larger audience. There can be no better tribute to the memory of the late A. D. Shroff who made remarkable contributions to the fields of banking, insurance and industrial finance.

The Trust has great pleasure in presenting this publication which is based on the public lecture by Mr. N. Vaghul, Chairman and Managing Director of the Industrial Credit & Investment Corporation of India Ltd, in October 1989 in Bombay.

Mr. Vaghul has made significant contributions to the banking industry in India, in the course of the high offices which he has held, having had his grounding with the State Bank of India and, thereafter, as the Chairman of the Bank of India.

This brilliant analysis could not have come at a more appropriate time, since Indian banking which has expanded at a phenomenal rate, is at the crossroads today, striving to reconcile rapid and large—scale expansion with quality in service. Mr. Vaghul emphasizes the importance of quality not merely by precept but by example—the quality of his own lecture being so clearly first-rate! He has been forthright in his views as can be seen from the contents of this booklet. The message ought to reach all bankers and bank employees, and those in charge of formulation and administration of banking policies, and the banking public.

N. A. Palkhivala
Chairman
The A. D. Shroff Memorial Trust

Bombay
20th December 1989

QUALITY IN BANKING*

N. VAGHUL

First of all let me express my sincere pleasure and happiness for the opportunity given to me to be here with you this evening. I consider it a great privilege to be called upon to deliver this memorial lecture. I consider it a greater privilege sharing the platform with Mr. Palkhivala. I have been regularly listening to his speeches on the budget for over two decades now. Of course, I have heard him speak not only on the budget but on several other matters. I particularly remember his speeches on Aurobindo's philosophy, which I value greatly. I never dreamt at that time that I could ever share a platform with him. I am therefore, naturally grateful for this rare opportunity which has been given to me.

This is the text of the Annual Public Lecture organised by the A. D. Shroff Memorial Trust in Bombay on 12th October 1989. The author is the Chairman and Managing Director of Industrial Credit & Investment Corporation of India Ltd., since 1985. He began his career as Probationary Officer in State Bank of India in 1957. He was Director of National Institute of Bank Management from 1976 to 1978; Executive Director of Central Bank of India from 1978 to 1981; and Chairman and Managing Director, Bank of India from 1981 to 1984.

I must admit that I have never known Mr. Shroff personally. We shared one thing in common though; I later on came to occupy a chair which he once adorned with distinction — he was the Chairman of Bank of India and I became his successor two decades later. I was still a young officer in banking when he passed away. His name was quite a legend in the financial circles then. Mr. Palkhivala mentioned that Mr. Shroff used to express his views honestly and frankly. Honesty and frankness are always great virtues but more so at that particular point of time when the nation was riding a wave of socialism. The romantic idea of socialism was finding widespread appeal in the country and was capturing the imagination of youngsters like me, when Mr. Shroff boldly came forward and propogated the idea of free enterprise and market-oriented economy. Subsequent events in the country have vindicated Mr. Shroff's stand. The ideas which he boldly preached have now come to be recognised world-over. The bastions of communism have fallen and countries such as Russia, Poland and Hungary, one after the other are embracing free enterprise and market-oriented economies with a considerable amount of zeal. Perhaps by the turn of the century these countries may well become the true champions of free enterprise; not so much the present ones, America, Japan and Western Europe.

When I was in Russia about four months back, I was quite startled when a group of Soviet economists became so vehement in their criticism of the state monopolies. The criticism was not a mild rebuke but very devastating in its content. The present freedom of expression in Soviet Union gives them ample scope to express their views frankly and fearlessly and they are coming forward with their bias in favour of individual initiative as the sure road for success for societies. It is now being widely recognised that centralised control over the economy and rigid state planning can no longer contribute to the prosperity of the nation. Nobody doubts this even in our country. If at all there is a debate in the country, it is on the question of the pace of liberalisation.

But today's talk is not about the state monopolies nor about the state controls. I wish I could talk more about the evils of state planning but I have deliberately chosen a different subject which to my mind is equally important. Over a period of time I was getting concerned about the obsession which we have developed for the number game which we have been playing, the quantitative emphasis which we have been laying on growth not only in banking but in several other spheres. I thought that a stage has come when we have to think seriously in terms of quality. That is the reason I have chosen quality as a topic for discussion today.

Sometimes I wonder whether we really understand what quality is all about. It occurs to me that quality is like Brahman which defies definition; something which you can feel and experience but which you cannot define, which you cannot describe in very clear terms. Many of us relate quality to a particular product, say quality of a chair, quality of a table, quality of a paper. These are some of the things which we can feel and experience but it is difficult to clearly define what it is that brings about this quality perception. Quality, however, cannot be confined to a narrow concept — something which is applied to a perception of a specific product. It is to be given a wider and broader connotation.

Quality is something which permeates every walk of our life. The way in which we conduct ourselves, the way in which we walk, the way in which we think, the way in which we function; every aspect of our life has to be permeated by this quality. It is this broader connotation of quality with which we have to concern ourselves. If we carefully introspect we will find that while the proximate cause of the evils in our country today, social, political and economic, can be traced to several factors, the root cause lies in the fact that we have been indifferent to quality - quality as defined in broader terms, which includes, the whole set of values, norms and ideologies. By sacrificing these we have contributed to the steady deterioration of the society and the emergence of the social evils.

About three years back, I was listening to a very famous Swamiji in Bombay, Swami Ranganathananda from Ramakrishna Ashram and he was explaining the concept of symbolism in Hndu Mythology. He was trying to explain the significance of goddesses Saraswati and Lakshmi. To most of us they represent the polytheism of the Hindu religion — the multiplicity of gods and goddesses. He, however, suggested a new interpretation. He said that these goddesses really represent concepts. In those days when learning was not so wide-spread and they were trying to convey a message to the people who were not literate, it was not unusual to illustrate the concept with figures. He maintained that the goddess Saraswati represented the concept of knowledge while Lakshmi represented the concept of wealth — not so much the concept of wealth but the concept of welfare because wealth and welfare were indeed synonymous at that point of time. Only subsequently, creation of wealth did not necessarily lead to welfare because wealth became concentrated in a few individuals and was not widely distributed.

When we worship these two goddesses we worship knowledge and welfare signifying in essence, the pursuit of knowledge and welfare which are the two critical factors for the success of society. What we need today, perhaps is a modern saint who will come forward and introduce a third concept namely, the concept of quality and choose an appropriate goddess to symbolise this critical factor which is vital to the progress of the society.

There was a time when Americans were making fun of Japanese obsession for education, the way their children used to work for 16 to 17 hours a day and the extreme concern which the mothers had for their children's education, ignoring everything else. Their aim was that their children should get admitted into one of the top universities in Japan, may be the Tokyo University or some such other University. The Americans found this all very amusing. They made fun of the fact that the Japanese did not know how to enjoy their leisure. Last month when I was in the United States I saw several advertisements on the television exhorting the parents not to ignore the education of their children and repeatedly emphasising that future of the United States depended on an educated population. The President of America says that in the next five years his major goal would be to reform education and he would rather like to be known as the education President. This is a classic example of a society which is indifferent to the goddess Saraswati, and therefore forced to surrender leadership to someone else. What is true of the concept of knowledge is equally true of the concept of welfare and quality. This is why I feel very strongly that in our country there has to be a quality movement.

But I am not here to talk to you about quality in general. My mandate today is to confine my remarks to banking. But banking after all is but a segment of the country. What is true of banking should equally apply to the country as a whole. And what is happening in banking? Mr. Palkhivala was quite right when he said that banking had seen tremendous progress during the last 20 years. Nobody can deny this. The banking scene has been transformed during this period and it is my good fortune to have been a witness to this transformation. The transformation covers a broad area — branch expansion, deposit mobilisation and credit deployment. The explosion in the number of branches has indeed been momentus. I do not want to quote any figures because I do not want to get into the number game but the achievement in this regard is truly impressive. The diversification achieved in credit deployment is also something that the banking industry can be justly proud of. From a handful of people who have been receiving the bank finance, the banking clientele has enlarged to cover groups such as small scale industry, agriculturists, small businessmen and landless labourers.

One should not underplay the role banks have played in the economic development of the country so far, particularly in regard to the growth of savings ratio. This ratio has gone up from something like 10 per cent in the fifties to 23 per cent today. This is not a mean achievement for a developing country. This by itself has brought about a degree of self reliance in the sense that we are able to finance nearly 90 per cent of our development by our own internal resources.

Having said this we should ask ourselves this question; while the quantitative achievements have indeed been impressive what about the quality? What is the price that we have paid to the growth in banking? Has there been a sacrifice in the form of quality? If so, how serious is the problem and what measures can be taken to retrieve it?

Let us be honest enough to accept the realities. The banking quality has indeed declined. The quality of service has declined, the quality of housekeeping has declined. One sees a qualitative decline in the various parameters in the banking system. This is what is causing the problem now. Banking aptly illustrates the point which I made earlier that if one is going to get obsessed with quantity and not pay attention to quality, he is bound to get into a serious situation. When a child is born the doctor will weigh the child and will keep a careful progress chart of the weight of the child every week or so. Whenever the doctor says that the child has gained weight, the mother would indeed be very happy. This is a stage in which the child will have to put on weight. But at my age when I go and weigh myself on the weighing machine and I find that I have put on 2 kilograms in my weight, I become miserable because at my age I am concerned more with the quality of my health, the elevated blood-pressure, my blood sugar, etc.

What is relevant for growth at a particular point of time need not necessarily be true all the time. A decade back, we in the banking industry used to take pride in the fact that we were opening two branches a day or that we were mobilising 1000 crore deposits or that our deposits were growing at over 20 per cent. When somebody asked us about our plan we gave them our branch expansion targets, our deposit targets, our priority sector targets. May be all this was relevant at that time but at the present stage what is relevant is quality, steps to arrest the deterioration in quality.

Let us take one parameter namely, the quality of assets. How many of us are really aware as to what is the true quality of the banking assets in the country? The Banks in our country have one important advantage. They are not obliged to tell anybody about the quality of their assets. They are protected by a secrecy law by which they are not obliged to disclose the extent of their doubtful loans, the amount which they provide every year for covering their doubtful loans, or the amount which they write off every year as bad debts. This secrecy provision is really a hangover from the British banking practices. It has its roots in the belief that the banking system functions on the basis of public confidence, and if the public were to come to know the extent of bad debts or doubtful loans, the public confidence in banks could be eroded and the financial system could well be in jeopardy.

Whatever might have been the merits of this practice when the industry was in its infancy, in the present times the secrecy law creates only vague fears and apprehensions arising principally out of non-availability of information. Realising this the banking system world over, has abandoned this concept. They are now making full disclosure of their non-performing assets and the aggregate provisions which they are making. Contrary to the belief held earlier, this full disclosure has not created any problems for the banks. The public have come to realise that banking business is indeed risky and that there are bound to be bad debts and doubtful loans but so long as these are within manageable limits and prudent provisions are made out of profits, the public confidence in the banking system is fully maintained.

My contention is that the banking industry in India should also move towards a system of public disclosure of the quality of their assets portfolio. Only through this process will it be possible to bring about a quality consciousness and focus the banks' attention on the need to improve the quality. This is a major point I want to make today.

The disclosure has to cover three broad areas. One is the number and amount of doubtful loans — what is generally known as non-performing assets, the provisions held thereagainst and finally the amount of bad debts written off every year. The disclosure will naturally have to be in aggregate terms. The secrecy of bank's relationship with an individual client is based on a different concept altogether and needs to be continued. It is also necessary to lay down an objective criteria for determining whether a loan is performing or not performing. When it is entirely left to the discretion of the bank to identify the doubtful loans, the public confidence in the veracity of the disclosure may not be fully established. It is however possible to evolve an objective criteria on the basis of receipt of interest in respect of a loan. If interest is not received in respect of a loan for 2 years or 3 years or whatever period is determined, the loan should be rated as non-performing. This is strictly an accounting criteria — no room for discretion, no room for exercise of individual judgement.

All doubtful loans or non-performing loans need not necessarily be bad debts. The distinction is important and will have to be maintained. What is meant by a non-performing asset is that the asset is not performing its function for which it has been created namely, to earn interest. If it has stopped earning interest it has become non-performing. Under the present somewhat loose accounting practice, it is possible for a bank to book interest on an accrual basis in respect of a loan which had long become non-performing. Thereby a bank can show an increase in profits. This profit is really a notional one. The chances of realising the interest might indeed be remote. What is more tragic is that on such accrued interest, the bank ends up paying tax and this is a cash outflow not matched by any cash inflow. So long as deposits continue to grow at

15 to 20 per cent, this mismatch between cash outflow and inflow does not result in any liquidity crunch. Once we adopt really objective standards in determining non-performing assets and insist on full disclosure, we would get a true picture of the banks' profits and also their financial position.

Initially, this could create some traumatic experience for all concerned. A lot of questions would naturally be raised; some disclosures could indeed be painful and could invite a lot of public criticism. But we should steel ourselves to face the situation squarely. I believe that in the final analysis the public will show the necessary maturity and understanding in facing realities. Banking industry would also emerge stronger by getting the dirt out of the carpet, cleaning it and not allowing the dirt to accumulate once again. There could also be problems arising out of comparisons with international banks. It would take some time to convince the critics that banks in India have a developmental role and combine social obligations with commercial consideration and as a natural corollary are bound to face a much higher risk than what is considered tolerable in the developed world. Generally banks in the developed countries are conservative and do not finance start-up propositions. India is one of the very few countries where it is possible for a start-up venture to get finance on a liberal basis from the banking system. Naturally, therefore, the failure rate is bound to be high; there is nothing to be shocked about this.

The great merit of a public disclosure is that instead of sweeping the problem under the carpet and hoping to deal with the problem at some stage in the future, we resolve to face the problem squarely here and now. Also, it is bound to bring about an internal discipline in the bank because once the bank makes itself publicly accountable, each and every one of its managers and executives would strive to maintain the quality of assets. The quality consciousness is bound to permeate the organisation over a period of time. Without doing this if we merely lecture to the banks about the improvement of quality and the need to improve the quality of assets, I am afraid no improvement will be brought about. Over the last 20 years, several circulars have been issued to the branch managers, exhorting them to follow-up the loans intensively for the purpose of recovery but there is no evidence to indicate that these circulars have had a positive impact on the situation. I believe that the improvement can take place only when the branch manager develops an internal discipline for quality consciousness and this has to be part of this quality movement.

The public disclosure will have an incidental advantage in regard to the handling of the sick accounts. It is not unusual for the banking system to postpone decisions in respect of rehabilitation of sick units indefinitely if the solution proves intractable or calls for a set of reliefs and concessions which could result in the booking of an immediate loss. Invariably the banks feel that so long as they could book interest on an accrued basis and the balance sheet looks healthy, there is no specific urgency to deal with the problem but once the non-performing nature of these loans is publicly recognised and creates a negative impact on the balance sheet, there is reason to believe that speedier and more practicable decisions in respect of rehabilitation of sick units could be forthcoming.

I may be pardoned for talking quite at length on the quality of assets but I am firmly of the view that in the final analysis it is the quality of the assets in the balance sheet that is most important for a bank. The strength of a bank does not lie in numbers. It lies in the quality of the loan portfolio. If the quality of the loan portfolio is not improved, we are being grossly unfair to the succeeding generation. We may perhaps ride through the next few years somewhat comfortably and get away with pushing several problems under the carpet. Perhaps many of us have really that much of time before our retirement. We can get into a feeling that there may not be any major catastrophe during our time, but I do not think it is a fair proposition for the succeeding generation. The succeeding generation will never excuse us for the stupidity with which we have handled the present situation and this is what I am really concerned about.

I should also mention something about the quality of other aspects such as customer service and housekeeping. So much has been written about the deterioration in this area that I can hardly add anything new to what has already been written and spoken. This deterioration in my view, is not related to the fact that banks were nationalised. I cannot imagine that on the 18th of July 1969 the employees of the banking industry were angels and that on the 19th of July their behaviour completely changed because Government took over the banks. This somehow does not fit in with my understanding of human behaviour. This deterioration has been steady and has been taking place over a period of time.

How do we tackle this problem? In arresting this deterioration we have to intervene in two spheres — One is systems. All the systems that have been developed in this industry owe their origin to the 1920s by a group of Scottish bankers; what they said in the 1920s is believed to be valid even today. The system which was found adequate for a set of 20 transactions cannot obviously cope when transactions have increased thousandfold. We have no doubt modified the systems; changed technologies here and there but the core of the system remains the same. It is not possible for the banking industry to manage any longer on the basis of the existing systems; but for developing new systems there is considerable amount of reluctance and resistance. Some of the resistance is ideological and flows from the trade unions who are opposed to using computers for development of systems. For trade unions computers appear as a man-eating tiger. I really do not know whether their apprehensions are justifiable.

I look upon computers as part of a system and for me the system is more important than the machine.

Why should we deny ourselves the advantages of technology? We are really getting into an endless argument in so far as the employment aspect of technology. I do not know how far it is true but, I was told that way back in the early 20th century, there used to be demonstration in the writer's building in Calcutta against the installation of typewriters because it was considered to be a labour-saving device! The more and more I think, the more and more I realise that computerisation is inevitable. We cannot stop the march of technology, the flow of technology. It has to come about. By delaying this we are not only doing damage to ourselves but also not helping the process of quality.

I am aware that quality improvement cannot be brought about by improving just one or two areas. Several other factors also will have to be taken into account — e.g., quality of assets to a large extent depends on the environment in which we are operating, the economic development which we are going through. It depends to a large extent on the development phase of the economy and the industrial climate. It also to a large extent depends on our legal procedures, the way in which we are able to recover loans from sick units. When a unit becomes irrevocably sick, when it becomes dead infact, we should recognise the corpse and should be able to remove it. I am amazed that some are not in a position to recognise death when it takes place. They hug the unit like a mother who hugs a dead child and says "I will not give it a burial, I am so attached to this child. Please do not take it way from me". This is the way the owners of some of the dead units are hanging on to their units and the corpses are creating a stink all over the place.

I recognise the fact that for improving the quality of assets, some of these things will have to change. But what is more important is the individual initiative in an organisation, because part of the problem lies in the appraisal process and the indifference of the individual who makes the initial assessment and who contributes to the decision-making process. This lack of attention to quality also contributes to a significant extent to the deterioration in the loan portfolio. It is easy to take shelter under somewhat difficult and unhelpful environment and absolve ourselves of individual responsibility.

The point which I am trying to make is that ultimately, the improvement in quality boils down to the individual. We can improve our systems, we can improve our policies, we can improve our environment. None of these things is going to make a difference until and unless the individual is surcharged with quality consciousness. The banking industry today has the most talented work force in the country. This is a fact that one has to recognise. Over the last two decades the banking industry has attracted to itself some of the finest young men and women in India. The reason is partly because it has paid high wages and partly because it has a good working environment, service conditions and liberal perquisites. Why have we allowed this work force to develop a feeling of apathy? This apathy is not confined to one segment of the work force namely, the clerks. It extends to officers and the executives in the middle management; perhaps it extends even right up to the top.

Who has to take the responsibility for this state of affairs? Management or the union leadership? To my mind both are equally responsible for the degeneration in the quality of the work force, for the failure to recognise and exploit the richest resource in the organisation, for failure to motivate the employees to high levels of performance. This ought to be our goal, this ought to be our objective.

What I have been saying about the banking industry would apply with equal force to the country at large. I would like to see the emergence of the quality consciousness in a substantive measure and to my mind this holds the key to our progress. I would like to emphasise that what I am talking about is not a narrow concept of quality but something much broader in terms. It is so broad that it also includes the quality of thought. There was a famous saint who lived in the early 20th century by name, Swami Ramatirtha. You may not have heard of him. He was a remarkable person and was a contemporary of Swami Vivekananda. He died young, at the age of 35 years like most of the famous saints. He was the first person to my knowledge, who talked in terms of practical Vedanta, application of Vedantic principles to life. He used to reiterate in his lecture that there were seven principles which constitute the secret for success in life. I do not want to go into detail in respect of these seven principles. But I want to tell you that the primacy he gives is to what he calls quality of thought. The quality of thought he says is the basis for quality of action. So any quality movement will have to begin with the thought-process and has to envelop the individual consciousness; the target of the quality movement will be the transformation of the individual and only when the individual is transformed, the society reaps the results.

I began my lecture saying that we have to remove the obsession with the numbers. If at all there has to be an obsession, it has to be an obsession in favour of quality — reverence to a new trinity of gods or goddesses, knowledge, welfare and quality. It is this reverence which till take the country forward. Thank you very much.
