6. Summery of findings:

6.1 Based on the analysis of the primary and secondary data and interpretations, the findings of the study related to the set objectives have been presented in the following paragraphs.

1. It is revealed from the ‘VISION DOCUMENT’ published by the Reserve Bank of India in the year 2004 that the UCBs have made good progress during about 15 years of reforms. The number of UCBs increased from 1307 to 2105 registering rise of 61.06%, Deposits of the UCBs increased from Rs. 8,600 crores to Rs. 1,10,000 crores recording growth of 1179% and advances of the UCBs increased from Rs. 7,800 crores to Rs. 65,000 crores recording growth of 733.33%. The contribution of state of Maharashtra in this growth process has been almost 60%. However, the UCBs that were performing well during the earlier period, all of a sudden found it very difficult to get adjusted in deregulated interest rate scenario and are exposed to ‘Interest Rate Risk’ (IRR) in the dramatically changed competitive banking environment. It is observed that 46 UCBs have failed in short period of 30 months during the period of this study.

2. Working Capital of all selected UCBs has increased during the period of study. However, these UCBs have failed to convert this additional working capital in to profit. Theoratically, profit should increase with higher percentage as compared to the increase in working capital or it should be atleast constant. In fast changing competitive banking environment and deregulated interest rate regime, these UCBs have underperformed.

3. All 16 selected UCBs failed to control the inflow of funds by reducing the pricing of deposit products when the profitable deployment opportunities
were not available. As a result, these UCBs held the surplus funds either in form of excess C.R.R. or excess S.L.R. investments at lesser yields. Except the Janata Bank, all other UCBs suffered loss due to holding of excess cash. The minimum negative impact has been seen to the extent of 0.05 per cent of W/C in case of Vidya Bank and Cantonment Bank and maximum of 4.25 per cent of the W/C in case of Sambhaji Bank. Similarly, except Janata Bank all other UCBs have suffered loss due to excess investments in S.L.R. securities. Minimum adverse impact to the extent of 0.10 has been seen in case of Sambhaji Bank and maximum of 1.93 per cent of W/C in case of Ganesh Bank. This reveals that the UCBs have failed to price the products accurately, manage liabilities efficiently and have been victim of Interest Rate Risk on the Liability side of Balance Sheet.

4. On the Asset side of the Balance Sheet the UCBs have been exposed to Credit Risk and Investment Risk in a big way. All 16 UCBs have suffered set back due to N.P.A. provisioning. The negative impact of N.P.A. provisioning worked out to be minimum of 0.04 per cent of W/C in case of Sambhaji Bank and maximum of 1.94 per cent of W/C in case of Anand Bank. The adverse impact in case of grade – III and grade – IV UCBs is so severe that except Siddharth Bank and Janata Bank all other 6 UCBs have sustained loss. Out of 16 selected UCBs, adverse impact of M to M depreciation provisioning, i.e. Investment Risk has been seen in case of 9 UCBs. The negative impact of these 9 UCBs worked out to be minimum of 0.04 per cent of W/C in case of Sambhaji Bank and maximum of 0.29 per cent of W/C in case of Laxmi Bank. Severe adverse impact of Investment Risk has been seen in case of grade – III and grade – IV banks. Vidya Bank went in to loss whereas Sanmitra, Cantonment and Laxmi Bank extended their losses. This reveals that the UCBs have failed to manage both Credit and Investment Risks on the Asset side of the Balance Sheet. It also reveals that had the Risk Cost properly accounted been for during the pricing process, these UCBs would not have suffered losses.
5. It is further revealed that failure to manage Assets and Liabilities in efficient manner, pricing of products and managing various risks has put lot of pressure on the profitability of all 16 selected UCBs. Losses suffered by these UCBs have reduced their own funds in a big way. It has been observed that out of 16 selected UCBs only 4 UCBs i.e. Cosmos Bank, Mahesh Bank, Bhavani Bank and Cantonment Bank have own funds of more than 10 per cent of W/C. This indicates that the remaining UCBs are more risk prone.

6. It is also revealed that out of 16 selected UCBs none of the UCB has priced the ‘Risk Cost’ while pricing its products. As a result, NM of all UCBs have been affected to the extent of Risk Cost.

7. Out of 16 selected UCBs only two UCBs i.e. Cosmos Bank and Siddharth Bank could report NIM of above 2 per cent because of low risk cost and good existing NIM. Four UCBs i.e. Mahesh Bank, Seva Vikas Bank, Ganesh Bank and Janata Bank which reported the NIM of above 1 per cent but less than 2 per cent of W/C are borderline cases. In case of five UCBs i.e. Pimp. Chd. Bank, Sambhaji Bank, Vidya Bank, Sanmitra Bank and Gajanan Bank which formed 31.25 per cent of selected UCBs, the NM is below 1 per cent of W/C. The UCBs cannot afford to function at such low NM in competitive business environment. Unfortunately, Five UCBs i.e. Prerana Bank, Bhavani Bank, Cantonment Bank, Laxmi Bank and Anand Bank which formed 31.25 per cent of selected UCBs have incurred loss due to improper pricing of product. The net margin (NM) has turned negative after adjusting risk cost indicating that the Managements of these UCBs have run these banks in loss.
8. Interestingly, if the risk cost is not added then the 4 UCBs out of 5 UCBs which incurred loss will show positive NM. These banks are Prerana Bank, Bhavani Bank, Cantonment Bank, and Laxmi Bank. This indicates that these banks have totally failed in pricing their products.

9. Thus, 10 UCBs (i.e. 62.50 per cent) have not understood the concept and importance of NIM. Without considering the ‘Risk Cost’ at the time of pricing of products has affected these UCBs very seriously.

10. The study also revealed that majority if the UCBs have failed to understand the importance of NII and NIM and need ongoing monitoring. It is also observed that there has been no system for calculating the cost of various factors which influence the pricing the products. Thus the pricing of product has not done in a systematic calculated manner and was faulty.

11. It has been observed from the replies to the questionnaire during the field study that the decision to change the interest rate structure has not been taken by the Asset-Liability Committee of the bank in majority of the cases. Most of the UCBs follow other bank’s interest rate structure while pricing the products in their bank. UCBs do calculate neither product wise profitability nor breakeven point of the products offered. Many UCBs do not have any system to monitor the NIM in their bank. Most of the UCBs do not have credit rating system for the borrowers. UCBs are neither aware of the concept of interest rate sensitivity of the Balance Sheet nor they have any computerized system to calculate the interest rate sensitivity of balance sheet. Many UCBs have accepted that they neither give importance to gap analysis nor read the same. Similarly, they do not have any contingency plan in their bank. It is also observed that UCBs do not have adequately skilled personnel who understand the concept of Asset Liability Management and Risk Management.
6.2 Recommendations:

Following recommendations need attention of regulator:

1. Asset-Liability Management and Risk Management play very important role in competitive banking environment. Co-operative banking being integral part of the Indian banking system cannot be left outside of the purview of these concepts. Implementation of ALM and RM should be made compulsory irrespective of the size of the UCB. (Earlier the regulator has made these concepts mandatory only for Scheduled Co-op. UCBs in the year 2002). Fortunately, the Reserve Bank of India in the year 2008 has extended the scope of ALM and RM to all the UCBs in India.

2. Non implementation of directives of the regulator either in full or in part, should be considered very seriously by the regulator. Strict action is required to be taken against the defaulting banks.

3. The regulator has pushed the UCBs in deregulated interest rate regime and the regulator is aware that the Board of Directors of the UCB consists of elected members who need not be expert in the field of banking. Under the circumstances the regulator needs to educate and train the Management of the UCBs and provide them some basic structure which would help UCBs in calculating cost of various factors influencing final pricing of products. The proposed framework is explained in detail at the end of recommendations.

4. UCBs being financial organizations cannot afford to incur loss due to wrong pricing of products. At present, the authority to price the product is vested with the Board of Directors of the concern UCB. It is therefore recommended that the regulator through its directive should instruct the UCBs to calculate NII, NIM, Risk Cost, Non Interest Income, T/C and NM
etc as per the formulas suggested on quarterly basis and place the same before Board of Directors every quarter for their approval.

5. This would help the Board Members to know the exact status of NM for the financial year. It would also help them to take corrective actions on time. If the NM in particular quarter is not in line with the projected NM for the entire year then Board would have enough time available to change the pricing in next quarters of the same financial year and cope up with the shortfall.

6. UCBs have now adopted computerization in big way. Many of the UCBs have gone one step ahead and adopted CBS. As a result, it has become easy for the UCBs to finalize their accounts. At present the UCBs are allowed to make NPA provision and M to M provision at the end of the year. It would be of great help if both these provisions are made on every quarter. This would facilitate the Management to understand the exact Risk Cost and plan for the NM in the same year. This would certainly act as pre warning signals.

7. Massive training programs on the subject of Asset_Liability Management, Risk Management and Pricing of Products needs to be undertaken and it should be made mandatory for the UCBs.

**Following recommendations need attention of the Board of Directors:**

8. The Management of the UCBs needs to change their mindset. Pricing of the products is very important and independent function. It is revealed in this study that many UCBs are copying the interest rate structure of the other
UCBs operating in their area which needs to be discontinued immediately. Pricing of Products needs to be done in more scientific way.

9. The Management of the UCBs needs to understand that the pricing of product will differ from bank to bank as the Risk Cost of each bank will differ. While pricing the products the UCBs need to fully factor their Risk Cost. No doubt, this will help the UCBs to ensure the maintenance of adequate NM.

10. Mindset of the Board of Directors for maintaining NIM as well as to make simultaneous change in the interest rates on deposits and advances needs to be changed. Depending upon the interest rate sensitivity of the Balance Sheet the result of maintaining NIM can be achieved by making due changes either on asset side or on liability side or by using mix of both.

11. The Management of the UCBs need to calculate the NII, NIM, Risk Cost, Non Interest Income, T/C and NM etc as per the formulas suggested on quarterly basis and the decision of pricing of products should be based on it. The UCBs should perform this exercise on their own and need not wait for directive from regulator each time.

12. Monitoring of NM needs to be done on an ongoing basis, preferably on every quarter. Most of the UCBs are now computerized. The prudent Management would opt for conducting quarterly closing of books activity for the administrative purpose instead of yearly as is done presently for the legal purpose. This would certainly help the Management of the UCBs to calculate the probable Risk Cost and use this data to make necessary change in pricing of products to absorb the variations in Risk Cost. This will no doubt facilitate the management in understanding the position of
profitability for the current year well in advance and will act as pre warning signals.

13. GAP ANALYSIS which is considered as a very basic tool for countering ‘Liquidity Risk’ and ‘Interest Rate Risk’ needs to be understood and used in proper way by the Management of the UCBs. The regulator has suggested using this tool as mandatory; however, the Management of some of the UCBs is still not giving the required importance to it. This important tool is considered only as format of reporting. This basic tool gives pre warning signals to the Management. Hence, the Management needs to consider it very seriously. If required the Management of UCBs should conduct special training programs for drawing correct Inferences and taking timely corrective actions based on the analysis of the information by using this tool.

14. UCBs have now adopted computerization in a big way. Many of the UCBs have gone one step ahead and adopted CBS. As a result, no time is now wasted in collecting data from the branch level. The main hurdle faced by the banks in the early stage of implementation of the ALM is no more in existence. Further, the transforming of the entire Balance Sheet on the basis of residual maturity has become very easy with the help of software. Thus, the Management of the UCBs should take initiative in using ALM technique in more efficient manner.

15. If the economic conditions are in growth mode and the prediction of interest rate scenario is stable, the UCBs could improve the inflow of funds by increasing pricing of deposit based products. As the economy is in growth mode and interest rate scenario is stable there would be good opportunity to deploy these additional funds in more profitable way. However, while doing this the UCBs would have to match the sources and deployment at same time. Contrary to this, if the economic conditions are
in recessionary mode and the interest scenario is not stable, the UCBs could reduce the inflow of funds by reducing pricing of deposit based products. As the economy is in recessionary mode and interest rate scenario is not stable there would not be opportunity for safe deployment. It is observed during this study that the UCBs have failed to control the inflow of funds by reducing pricing of deposit based products and as a result they were forced to make investments of these surplus funds at a lower yield. This has put additional pressure on the profitability of the UCBs. Asset-Liability Management facilitates matching of Inflows and Outflows of funds on various time buckets by making necessary changes in the pricing of products either on asset side or on liability side or using mix of both.

16. It is observed in this study that the UCBs are very weak in managing various risks associated with banking business. Adverse impact of huge NPA provisioning which is the result of Credit Risk and adverse impact of huge M to M provisioning which is result of Investment Risks have changed the fortunes of the UCBs. Implementation of Risk Management Policy in the bank is must in today’s competitive banking business. The Management of the UCBs should do it on priority. Merely drafting of good Risk Management policy would not serve the purpose but awareness of it among the staff members working down the line is highly required. The Management needs to take efforts in educating staff members about the same. Use of simple tool like credit rating for the borrowers, improving standard of scrutiny, timely follow up of recovery are very simple things which needs to be followed for protecting bank against credit risk. Financial markets will always remain volatile. With the regulators directives UCBs would have to invest more and more funds into G-Secs, Bonds etc. All these instruments would be traded on the WDM and as a result the M to M provisions would increase or decrease. Understanding the nature of the instruments, predicting the interest rate scenarios and its impact on the valuation of investment portfolios would have to be actively
learned. The services of specialized training institutions should be used by the Management of UCBs for training the concern staff members. For acquiring necessary skills in the treasury department the Management should not hesitate to sponsor the fees.

17. The Management of UCBs needs to focus more on spending money on technology, on skilled personnel and on training. This has become the necessity of the present banking environment. Technology will ensure that the required information is made available to the management in very short period of time. Skilled personnel will no doubt ensure accurate analysis of the information and recommendation of corrective measures. Training will always ensure that the level of knowledge of the directors, senior management and other staff members is kept updated.

18. Educating the Directors, senior management and staff members on the use of these techniques needs to be done more aggressively. It is revealed from the study that the UCBs are failing because of improper pricing of their products. This needs to be changed through effective training.

19. Application of Gap Analysis would play very important role in managing Assets and Liabilities side of bank’s Balance Sheet. Keeping in mind the risk part of the banking business, simple technique of gap Analysis will certainly help these local UCBs in planning their bank’s balance sheet in a better manner to sustain greater risks. Further, the Asset-Liability Management would help these banks in fixing the correct price for their products. This would finally result in maintaining good interest spread which would help these UCBs to run banking business in profit. Accumulation of profit would surely ensure long term viability of these UCBs.
6.3 Proposed framework for the UCBs

(To be reviewed in every quarter)

- Calculate NII
  - Calculate W/C
    - Calculate NIM
      - Calculate and deduct Risk Cost
        - Calculate NFM
          - Calculate and add Non Int. Inc.
            - Calculate and deduct T/C
              - Calculate and compare NM with projections

Plan - A

If NM is at par or more than projected level, continue with same pricing policy with additional marketing efforts to increase volumes.

Plan - B

If NM is less than projected level, reconsider the pricing policy.
Plan – B

Find out the variation in NM (Projected – Actual)

→

Reconsider pricing policy

→

Take review of economic conditions, predict interest rate scenario and reprice the products

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Use ALM in pricing policy to ensure required NM

Use RM to secure required NM

Use ALM in pricing policy to ensure required NM

Use RM to secure required NM