CHAPTER VI

CONCLUSION

Main objective of this chapter is to present the summary of significant findings of the present study. The summary of main findings is followed by policy implications to improve efficiency of banks.

6.1 THE PROBLEM AND THE OBJECTIVES OF THE STUDY:

Historically the urban cooperative banking segment has been performing important role of mobilizing savings from urban low and middle income group and providing credit to micro enterprises who find it difficult to raise loan from commercial banks. Though the urban cooperative banking segment forms small proportion of banking segment in India its efficiency derives special importance considering its allocative focus on small and micro enterprises. Market share of urban cooperative banks in deposits and credit in urban and metropolitan areas was 9 and 10 percent in 2001 which declined to 4 per cent in 2008 due to slowing down the growth of deposits and credit during the high growth stage of Indian economy. Apart from this the asset quality of urban cooperative banks further declined that reflected in to the increased ratio of gross non-performing assets to loans from 11 per cent in 1998 to 23 per cent in 2005.

On this background an attempt is made in the present study to assess the improvement in efficiency and productivity of scheduled urban cooperative banks operating in the competitive environment created by the introduction of fairly deregulated regime since 1993. The analysis of indicators of productivity, namely, operating cost per unit of assets, net interest margins per unit of assets, net profits per unit of assets and business per employee, of urban cooperative banking segment is done for the period from 1997-98 to 2007-08. Bank-wise analysis is done for the period 2004 to 2008 for which the data are available. For the qualitative analysis of productivity and efficiency we selected two scheduled urban cooperative banks which fall at the two extremes of the range of profitability. Both are from Pune District in the state of Maharashtra. Both these banks, namely, Janata Sahakari bank and Cosmos cooperative bank are large banks and
among these two Janata Sahakari bank had accumulated losses during 2004 to 2008 which is the reference period of the study while Cosmos cooperative bank is profit making bank.

The specific objectives of the study stated in first chapter of the thesis are as follow.

1. To assess the evolution of urban cooperative banking segment in terms of size, the quantum of intermediation (deposits and credit) vis-a-vis the development of the commercial banking segment from 1967, that is the time since this segment was brought under RBI control till 2008.

2. To examine the trends in productivity/efficiency and soundness of the scheduled urban cooperative banking segment from 1998 to 2008. This segment accounts for 40 per cent of deposits and credit of the total urban cooperative banking segment.


4. To inquire into the impact of qualitative aspects like professionalism, governance and quality of loans on efficiency using two banks mentioned above as the cases in point.

First objective forms the focus of the third chapter while the second and third objectives are the focal points of the fourth chapter. The comparative analysis of productivity and efficiency of the two cases selected for the study is presented in the fifth chapter. Second chapter of the thesis deals with the theoretical arguments pertaining to the causal relationship between financial development and economic growth which provides the perspective for the issues discussed in subsequent chapters mentioned above.

6.2 OBSERVATIONS AND FINDINGS OF THE STUDY:

The observations and findings of various chapters of the study are as follows.
Theoretical and empirical literature on the causal relationship between financial development and economic growth reviewed in the second chapter is not conclusive. Among the schools explaining the financial variables influencing economic growth the financial structuralists suggested that the quantum of financial variables influence economic growth while the financial repressionists stressed on price variables as determinant of economic growth. According to neostructuralists shift from direct lending in informal market to bank deposits would reduce the quantum of lendable funds for productive investments and thereby reduce the rate of growth.

The development of Indian financial system in the initial years was shaped by the structuralist school till 1990s and then by repressionist school. Historically the Indian financial system has been based on intermediation and dominated by the banking system. The nationalisation of private sector banks in 1969 was a policy measure implemented to align the banking system to the needs of planning and economic policy. The main objectives of nationalisation were to widen the branch network, mobilise the deposits and direct credit flow to priority sector. The measures were also taken to promote the rural as well as urban cooperative banking segment and thereby bringing the financial flows in informal market in the ambit of formal institutional system. Against the neo-structuralist view on informal financial market India opted for restricting the size of informal financial market.

The directed spread of institutional credit at administered interest rate (financial repression) affected profitability of banks. Their capital base became weak and non-performing assets of banks increased. To overcome these weaknesses in the banking sector several measures were initiated in the beginning of 1990s. The financial sector reforms which were implemented along with structural adjustment programme were based on the recommendations of the MacKinnon Shaw model of the repressionist school.

Various policies for financial system have resulted in considerable financial deepening of the economy. The crucial indicator of financial deepening, namely, deposit
income ratio increased considerably particularly after 1999. The nationalization of banks stepped up the deposit income ratio from 19.3 per cent in 1972 to 44 per cent in 1991. In the initial years of reforms the pace of financial deepening was moderate which accelerated after 1999. After 2000 the deposit income ratio increased by nearly 30 percentage points to 84 per cent during the period of eight years. The deposit income ratio increased at the annual compound rate of growth of 3.59 per cent during the period 1972 to 1998 while this ratio posted a higher growth rate of 5.58 during 1999 to 2008.

The empirical studies tracing the relationship between financial development and economic growth of Indian establish both way causation in the growth of real money and growth in real GDP and growth in real bank claims and growth in real GDP. Thus according to this study the financial development exerts positive impact on economic growth which in turn influences economic growth.

The data on savings in Indian economy indicate that financial development has positively influenced savings but how much of these savings are transferred in to growth is not clear. The saving rate of the Indian economy continued to rise after nationalization of banks from 14.2 per cent in 1972 to 25 per cent in 1995 and remained around it till 2001 and it increased at an accelerated pace of after 2002 reaching the level of 36 per cent by 2007 during the high growth phase of the economy. The saving rate of the household sector which is the major saving sector in the economy more than doubled increasing from 10.4 per cent in 1972 to 24 per cent in 2003. It however declined marginally (by 1.5 percentage points) after 2003 during the high growth phase of the economy. Rising saving rates of private corporate sector contributed to the growth in gross domestic saving rate during this period.

The impact of financial development on increasing savings is witnessed from the increasing share financial savings of the household sector to gross domestic savings from 24 per cent in early seventies to 44 per cent by late nineties. Though this share declined after 1998-99 the bank deposits continued to be the most preferred form of saving of the household sector; nearly 60 per cent of the financial saving of household sector flowed in bank deposits in the latter half of the decade 2000.
Thus the above observations indicate that 1) the financial system is considerably developed as reflected in deposit income ratio of the economy 2) the gross domestic saving rate increased with the growth of the economy and 3) financial development promoted growth of savings.

Chapter III

The summary of the main findings of the analysis of the growth experience of urban cooperative banks during the entire period of phase II and III starting from 1966 that is since the urban cooperative banks were brought under the purview of RBI is presented in the following paragraphs.

So far as the size of the segment is concerned the analysis highlights that the number of banks increased at the trend rate of growth of 1.77 per cent per annum during the period 1966 to 2008. The pre reform period was characterized by stringent licensing policy hence posted lower compound growth rate of 1.48 percent per annum. The annual compound growth rate of banks increased to 2.14 per cent per annum during the post reform period due to liberal licensing policy. However one third of newly opened branches turned out weak in the short period of time. Hence the consolidation of licensing policy and mergers of weak banks led to declining trend in number of banks after 2003.

Deposits of urban cooperative banks increased at the trend rate of growth of 18.6 per cent per annum during 1967 to 2008 while credit increased at the rate of 17.6 per cent per annum during the same period. The pace of growth of both deposits and credit decelerated during post reform period as compared to pre reform period. The decline in the pace of growth in deposits could be attributed to the failure of two urban cooperative banks which displaced public confidence in the sector as a whole. The faster deceleration in the pace of growth in credit of urban cooperative banks could be also due to high NPAs that further restricted the availability of funds for lending. The NPAs of urban cooperative banks were higher during this period.
The growth of NDP from unregistered manufacturing also declined during post reform period. The elasticity of urban cooperative banks deposits and credit to NDP from unregistered manufacturing worked out to be 1.36 and 1.26 respectively during the entire period from 1967. These elasticities were higher in pre reform period as against post reform period.

The credit deposit ratios of urban cooperative banks have shown declining trend. However these ratios have remained above the credit deposit ratios of scheduled commercial banks till 2003. From 2004 the scheduled commercial bank's credit deposit ratio increased sharply and remained above the ratio of urban cooperative banks.

A comparison of the growth of urban cooperative banks and scheduled commercial banks reveal that the growth rates of deposits and credit of scheduled commercial banks were higher in post reform period as compared to pre reform period while the urban cooperative banks exhibited reverse trend in the growth rates of deposits and credit during these periods as mentioned above. The deposits and credit of commercial banks increased at a faster pace particularly after 2003 due to the high growth experienced by the Indian economy and improved financial health of this banking segment. The NPAs for all categories of scheduled commercial banks declined to a low level and remained around 1.0 per cent. Due to the disparate growth experience of deposits and credit by commercial banks and urban cooperative banks during this period the market share of urban cooperative banks in deposits and credit declined sharply after 2000.

Regarding gradewise distribution of urban cooperative banks it is observed that in 2008 the number of urban cooperative banks in grade I and II increased as compared to 2004 and the number of banks in grade III and IV declined during the same period.

No significant change in the statewise distribution of urban cooperative banks in India during the period 2004-2006 is observed. Concentration of urban cooperative banks in 5 states, namely, Maharashtra and Goa, Gujarat, Karnataka, Tamil Nadu and Andhra Pradesh has remained nearly 80 per cent during the same period. The
number of cooperative banks in other states has remained almost insignificant during the same period.

Chapter IV

The main findings that emerge from the analysis of indicators of productivity and efficiency of scheduled urban cooperative banks that comprises of 40 per cent of deposits and credit of urban cooperative banking segment are as follows.

The operating expenses to asset ratio of scheduled urban cooperative banks showed declining trend from 2.4 in 1998 to 1.76 in 2005 and then it marginally increased to 1.96 in 2008. This is well above Basel norm II which one. The rise in operating cost might have been due to expansion of branches by banks during the liberalised licensing policy of the RBI. It is important to note that the ratio of operating costs to asset of scheduled urban cooperative banks was lower than public sector banks except for the year 2008. However unlike scheduled urban cooperative banks the operating costs per unit of assets of public sector banks continuously declined from 2.66 in 1998 to 1.5 in 2008.

The parameters indicating labour productivity that is business per employee to asset ratio of scheduled urban cooperative banks increased by 50 per cent in 2008 over its level in 2004 where as business per employee of public sector banks increased by 90 percent during the same period. It indicates that labour productivity of scheduled urban cooperative banks increased at slower pace than public sector banks.

The ability of scheduled urban cooperative banks to generate income from credit and investment operations from their funds (deposits and borrowings) effectively which is reflected in the interest spread to asset ratio of these banks declined during the period 1998-2005 and remained below the interest spread of public sector banks. After 2005 the interest spread of scheduled urban cooperative banks showed increasing trend and it was higher than public sector banks in 2008.

Net profit to asset ratio which is an indicator of overall efficiency of scheduled urban cooperative banks showed negative growth during the period 2001-
2003. This was mainly due to very high negative profits of few large loss making banks. From 2004 onwards net profits per unit of assets showed increasing trend and it crossed one per cent which is the norm suggested by Basel II. It is interesting to see that the interest spread and the business per employee (labour productivity) for the sector also showed increasing trend during this period. The cross sectional data also show the positive relationship between the overall efficiency of the urban cooperative banks indicated by net profitability and labour productivity and net profitability and interest spread.

There is considerable variation in the indicators of productivity across the scheduled urban cooperative banks. The variation in net profitability and labour productivity (business per employee) increased after 2004. The increasing competition has somewhat reduced the variability in the spread of the scheduled urban cooperative banks as reflected in lower coefficient of variation of spread to asset ratio in 2008 (36%) as compared to 2004 (38%).

Majority of the scheduled commercial banks have CRAR above the prescribed requirement of 9 per cent during the study period. However the asset quality of ten out of 53 scheduled urban cooperative banks is a poor. Among these the asset quality of eight urban cooperative banks is severely impaired. Thus though the number of financially strong urban cooperative banks has been increasing over the years as noted by the Committee on Financial Sector Assessment these weak banks are the cause of concern.

Chapter V

The observations based on the case studies of two urban cooperative banks, one weak bank (Janata Sahakari Bank) and one strong bank (Cosmos Cooperative Bank) are based on the assessments of i) capital adequacy of the two banks in terms of capital to risk weighted assets ratio (CRAR), ii) asset quality of bank on the basis of ratio of non-performing assets to loans, iii) impact of NPAs on top line and bottom line of both banks, iv) the quality of corporate governance of the two banks on basis of the prescribed norms by the Reserve Bank of India, v) the diversification of the operations of the banks
on the basis of the share of non-interest income in total income of the two banks, vi) efficiency in cost management in terms of cost income ratio and burden ratio, and vii) efficiency in liquidity management on the basis of comparison of liquidity asset ratio and credit deposit ratio. The observations may be summarized as follows.

It is observed that Cosmos Bank has maintained CRAR according to the prescribed norms of RBI during the study period. Thus the capital adequacy of Cosmos bank is satisfactory. As the volume of banking business increased the amount of risk weighted assets also increased. Due to creditability and faith of shareholders, it was possible for Cosmos Bank to increase its share capital according to needs and to maintain CRAR as per RBI norms. In case of Janata Bank, due to losses Tier I capital was negative till 2008. As a result CRAR of Janata Bank was also negative. In 2009 Janata Bank was able to maintain prescribed CRAR by increasing share capital and raising long term deposits.

Due to high percentage of NPAs Janata Bank reported losses during the study period. NPAs erode current profits of a bank through provisioning requirements. Other adverse effect of NPAs is that they reduce interest income and thereby adversely affect profitability of the bank. In case of Cosmos Bank the percentage of NPAs is low and there is consistent increase in profits of Cosmos Bank. NPAs limit recycling of funds. Credit growth of Janata Bank was negative due to high percentage of NPAs, while there is continuous increase in credit growth of Cosmos Bank. Thus the financial performance of urban cooperative banks deteriorates if the percentage of NPAs is high and hence the asset quality of the bank is bad.

In a competitive environment net interest margins are expected to come under pressure. To sustain profitability banks need to improve their other sources of income. There is considerable fluctuation in the share of non-interest income in total income of both banks. This fluctuation is mainly due to rise and fall in profit on sale of securities of both banks.

The burden ratio of Cosmos Bank has remained higher than that of Janata Bank in most of the years. Non-interest expenses of Cosmos Bank increased due to
branch expansion and technology upgradation. On the other hand Janata Bank was in a better position to recover its non-interest expenses through non-interest income since its number of branches has remained constant during the study period.

As compared to Cosmos Bank, Janata Bank is maintaining low liquid asset ratio. However, credit deposit ratio of Janata Bank is considerably higher than Cosmos Bank.

By making efficient use of information technology it is possible for both banks to introduce wide range of products and services. Information technology also contributes to increase their business and to improve quality of assets.

6.3 POLICY IMPLICATIONS:

On the basis of findings from the present research study on two selected urban cooperative banks in Pune district, a modest attempt has been made to suggest following ways and means to improve overall efficiency in both the selected banks:

1. To improve profitability and credit flow, it is essential for Janata Bank to adopt better and efficient machinery for recovery of outstanding and to reduce the percentage of non-performing assets. The percentage of net NPAs to loans of Janata Bank is very high up to 2007. There is considerable decline in its NPAs during last three years. In 2009 percentage of net NPAs to loans of Janata Bank is 2.46 while it is 2.08 in case of Cosmos Bank. In 2009 percentage of net NPAs to loans of public sector banks is 0.7 hence there is a scope for both banks to improve their quality of assets.

2. A major portion of non-interest income of both banks comes from profit from security trading activity. Due to market fluctuation there is uncertainty to earn consistent profit from security trading. To avoid such fluctuations the banks, therefore, should focus more on earning steady non-interest income through safer and steadier means like commission, fees etc.

3. Share of current deposit in total deposits of Cosmos Bank and Janata Bank is very low. In 2009 share of current deposit in total deposits of Janata Bank is 4.83 per
cent whereas for Cosmos Bank it is 4.73 per cent. Due to smaller base of branch network than commercial banks urban cooperative banks are not able to attract current deposits which are interest free from corporate clients or big trading houses as commercial banks do. Both the banks should focus on increasing the percentage of current deposits in their total deposits to reduce cost of funds.

To sum up the urban cooperative banking segment which constitutes important segment of Indian banking system has experienced phenomenal growth after this segment was brought under the purview of RBI in 1966. The pace of increase in the number of urban cooperative banks accelerated in the deregulated regime after 1993 however the pace of growth of deposits and credit decelerated during this phase. The study highlights that the scheduled urban cooperative banks have gained in terms of productivity and efficiency due to competitive environment created by reforms. The net interest spread and operating expenses have declined and profitability of the sector has increased. The impact of reforms which was slow till 2001 has accelerated after 2004. The Committee on Financial Sector Assessment notes that the number of financially stronger urban cooperative banks has been increasing in recent years. Though the asset impairment ratios are higher than commercial banks have improved but the accumulated loss is a cause of concern.

To survive in open market economy, urban cooperative banks should develop the capacity to face the competition and new challenges through internal strength, self supportive and quick decision making, professional management, human resource development, optimum utilization of the existing infrastructure, emphasis on modernization, upgradation of technology and strict financial discipline. They will have to analyze their strengths and weaknesses and develop a course of action to strengthen their base and flourish in the present scenario.