Chapter -8

**PROBLEMS**

- Problem of dual control
- Lack of level playing field
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CHAPTER 8

PROBLEMS

One of the major areas of the macro economy that has received renewed focus in recent times has been the financial sector. One might attribute this to two reasons. Firstly, as Stiglitz (1999) has observed, the financial sector acts as the 'brain' of the economy: it acts as a conduit for channeling resources from final savers to final investors. As a result, the greater the ease of resource intermediation, the lower the cost at which these resources can be available to final investors, enhancing investment and growth. Secondly, the worldwide trend towards de-regulation of the financial sector, ascendancy of free market philosophy and the widespread banking problems that have plagued several economics since the eighties have raised a gamut of questions relating to the linkages between de-regulation, various categories of risks facing the banking sector and banking crises. According to Lindgren et.al. (1998), since 1980, over 130 countries, comprising almost three fourths of the International Monetary Fund's member countries, have experienced significant banking sector problems, with 41 instances of crisis in 36 countries and 108 instances of significant problems. Consequently, the banking sector, or for that matter, the financial sector in general, in most emerging economies are passing through challenging yet exciting times. In the
Indian milieu, given the wide diversity within the financial sector itself.

Urban Cooperative banks were set up with the avowed objective of promoting sustainable banking practices amongst a relatively specific target clientele viz., the middle income strata of the urban population. They were brought under the regulatory ambit of the Reserve bank by extending certain provisions of the Banking Regulation Act, 1949, effective from March 1, 1966.

It might be useful to briefly recount the basic structure of the cooperative banking sector and locate Urban Cooperative Banks as a group within. The cooperative banking sector may be viewed as consisting of Rural Cooperative Banks and Primary (Urban) Cooperative Banks. Leaving aside the structure of Rural Cooperative Banks, Primary Cooperative Banks, numbering 1,936, have a network of over 6,300 branches catering to the banking requirements of the lower and middle income groups in urban and semi-urban areas.

Urban cooperative banks of Uttar Pradesh are facing many problems because of inefficient staff and management. They are unable to do their work in a vast area because they have very limited resources. Most of the banks are trying to show good results but they are helpless in front of the problem of dual control. Problem of dual control in not only effecting this particular state but effecting other states also. In spite of it, committees are in favour of another controlling body. These banks are facing difficulties during recovery of loans & Advances, specially in statutory investments. The cause of problem is political interference, which is a big barrier infront of this sector.
PROBLEM OF DUAL CONTROL

Taking into consideration the enormity of the crisis related with Uttar Pradesh urban banks and others state's urban banks, calls have increased for a greater role for the RBI as a regulator of the urban co-op. banking sector. At present these banks are under the dual control of the RBI and the Registrar of Co-operative Societies. Under this system, the RBI only has Jurisdiction over the banking operations of the cooperative society while the registrar looks after the managerial and administrative functions. So there is no single instructor for these banks to operate there business. It is absolutely necessary that the RBI Should be the role regulator of the banking business carried on by urban co-operative Banks and dual control must end, and end soon.

However the greatest challenge in cleansing the system would be the state Government and domestic industries, both of which enjoy a tremendous amount of influence on the co-operative banks. The high Power Committee on urban co-operative Banks noted RBI's attempts to get even model bye-laws adopted by state governments had drawn blank. The State governments had also ignored recommendations by earlier committees set up by the finance ministry or the RBI. Some banks had even overlooked RBI's orders on interest rates.

Controlling bodies have'nt learnt any lesson from, Madhavpura Bank V/s Stock Broker's Case. Ahmedabad-based Madhavpura Mercantile Co-operative bank was established on October 10, 1968 to cater to the varied financial needs of wholesale grocery traders in the Madhavpura. It had 12 directors on its board that included its chairman, Ramesh Parikh and its CEO and MD Devendra pandya.
The bank received a scheduled bank status from the RBI, which allowed the bank to expand its banking operations and start lending to stock brokers. The scheduled bank status also allowed the bank to invest 10% of its net worth in the capital markets. The bank had managed to resist the allure and glamour of investing heavily in the capital market. But, the relationship between the bank's chairman Ramesh Parikh and big bull Ketan Parekh did the trick and the bank reported to have made huge advances in a couple of months. The advance made by bank to Ketan Parekh were pegged at around Rs. 2 bn. However, the bank faced its warrt crisis on 8th march when depositors panicked and started with drawing money from the bank. The result the bank was left with very little cash. The problem of the bank were further compounded when it had to down its shutters in Ahmedabad and Mumbai.

Depositors were not the only ones to have been hit by the Madhaupura Bank crisis. With their money locked in Madhapura Bank, many co-operative banks also faced payment problems. Those who resorted to the call money market found no lenders as commercial banks kept away from them.

The crisis forced the RBI to step in and take some action to limit the damage. A preliminary inquiry by the central bank showed that the bank had a very bad liquidity position after it issued pay-orders worth Rs. 650 mn. to the depositors. The RBI was left with no other option but to recommend the central Registrar of co-operative Banks to supersede the board of the bank.

This Scam has brought to light the fact that loopholes within the banking system exist and the RBI as a banking regulator failed to respond quickly to the challenge posed by the scam.
Some banks seem to have learnt a lesson and has decided to plug the loopholes that allowed Madhavpura Bank and stock Brokers to play havoc with the market. The RBI has reportedly drawn plans to revise pay order and demand draft discounting norms; Stock lending norms; banks capital market exposure norms and gold lending norms.

Urban Banks of Uttar Pradesh are facing same kind of problems and are unable to recover their advances because of the absence of straight guidelines by one controlling bodie. Duality multiplicity of control of the credit co-operatives comes in the way of effective regulation and supervision of co-operative banks. The Major issue in this context is the overlapping jurisdiction of the State Government and the RBI. Successive Committees have recommended that there should be clear demarcation of areas of regulatory responsibilities between the State Government and the RBI. It has also been recommended that the RBI should regulate and supervise the banking operations of the UCBs. Although the RBI has concurred with such recommendations and advised the State Government to undertake suitable legislative amendments, the issue has not been resolved so far. Given the serious implications of the lack of clear-cut jurisdiction over regulation of cooperative banks, it has been proposed by the RBI to rationalise this system by establishing an appropriate unified regulatory authority for UCBs with representatives of Centre, States and other interested parties. The Central Government, in turn, view that the issue be resolved through appropriate amendments in the B.R. Act, 1949 rather than through amendment of respective State Co-operative Societies. Subsequently, RBI has submitted a draft Bill which is under Consideration of the Govt. This important issue was examined by a Committee (Chairman : Honorable Minister of State for
Finance). While RBI will do its best in implementing the final decisions of the Government in this regard, in case immediate measures are not taken to remove duality of control, it will be difficult to make the supervisory system effective.

**LACK OF LEVEL PLAYING FIELD**

Admittedly the Urban-Co-operative banks have been striving to solve the economic problems of lower middle class of Uttar Pradesh, especially of the people belonging to the weaker sections. From their very inception they have been trying to provide credit facilities to the common man. They may very well claim to have contributed in their own way towards the establishment of socialistic pattern of economy in the country. They have not only tried to meet the economic needs of the public but have also helped the needy in periods of natural calamities of the Public but have also helped the needy in periods of natural calamities like floods and earth-quakes, and all these facilities have been provided by them without any facility or encouragement from the state or the central Government. Despite their unfavourable position they have mobilised deposits from the public in open competition with the commercial banks.

But the success achieved by these banks does not go to prove that they are free from organisational and operational problems.

The urban co-operative banks are treated as primary co-operative societies and are not eligible for membership of the apex bank. Consequently they are not eligible to receive any facility from the apex bank. The working group appointed under the chairmanship of Shri P.N. Damry had recommended that all reimbursement facility under the reserve Bank of India act may be made available to these banks through the apex bank. The co-operative banking should be under the
direct control of the RBI and the co-operative act should only be implemented for registration purposes. Similarly the board of directors should be provided with powers to refuse membership to any person, subject to the right of appeal to the association of urban banks, i.e., not to a third party like the registrar but to federal body of banks themselves. This would no doubt mean that the principle of open membership will not be operative. But, all would agree that the principle of open membership can’t be allowed to operate at the risk of admitting disruptive elements.

The development of urban co-operative banking has not been uniform all over the country moreover, the number of dormant societies has been increasing year by year. The chief factor for the increasing number of dormant banks can be the competition they are facing at the hands of commercial banks in matters of deposits. The central co-operative banks do not provide sufficient funds to these banks.

It would not be out of place to mention that despite the increased planning efforts and increased tempo of economic development, wide recognition of the importance of co-operative sector as a balancing factor and despite the promotion of agricultural co-operatives, industrial co-operatives and co-operatives for backward and weaker sections of the community, enough attention has not been paid to the development of non-agricultural credit co-operatives. The urban credit co-operatives can play a significant role in the economic development of state and also the country. They can bring together middle and working classes, mobilies savings, provide credit facilities on reasonable terms to middle classes, provide investment opportunities to persons of low means. provide finance to industrialist and artisans, extend banking facilities to persons of small means, and
above all they can provide active leadership to the co-operative movement in urban areas. Similarly the employees credit societies can develop habit of thrift and self help, provide surplus funds to other sector of economy, act as a friend-in-need to salaried persons, undertake activities for the welfare of the members and their families and can provide active leadership for the movement. It was with these considerations that the study group on credit societies in non-agricultural sector had recommended that effective steps should be taken to increase the coverage of these Banks to 50% of the urban population. It had recommended that each town should be covered with at least one urban co-operative bank.

**HIGH COST OF DEPOSITS**

High cost of deposit is another problem facing by these banks. Banks are not able to attract their customers and are fail to win their trust. Most of the urban banks are in a worst condition. They have no facility of sitting, record keeping, and are not using new technology like computer, ATMs etc. They adopt a lot of formalities during deposit services. Their expenses relating to maintenance & securities of books and documents is very high. Yes, we can say that the deposit fee and security fee is equal to commercial banks but it is not sufficient for a customer. Customer have made a picture of bank which provides him a number of facilities. Interest on deposit is also a main factor. These days banks are in a competition of high interest in deposit but the problem with these banks is that they can't compete with commercial banks in this manner, there collection (Deposit) is not better than Commercial banks. For a large amount of deposits many banks have adopted a liberal interest policy and have become fail.
INCONSISTENCY OF MANAGEMENT

These banks have also been facing problem of management. In larger bank the calling of the general meeting is a problem. In some Banks, the attendance at the general meetings is very poor and they are dominated by a few individuals. Election of Board of Directors is another problem.

Because of indiscriminate supersession of distributive co-operative the element of democratic management is missing. Super contradicts one of the plan objectives, viz. "Promoting the active involvement of people in the process of development".

In a large number of cases, the Boards of directors and the appointed management are not quite conversant with their defined roles. As a result, these banks are not managed on sand principles of scientific management.

A good manager is equally essential for the success of a urban bank. While many steps have been taken during the post-indipendence period for the development of bank's activity, yet a very vital aspect of building management core of the movement has escaped attention of both the government and the co-operative leaders. In no other field, the co-operatives have to face such a stiff competition as in case of urban co-operative Banks. It is, therefore, very essential to appoint really competent and skilled persons on managerial positions in these Banks. Steps should also be taken to make the job of the manager of banks very attractive, both in terms of remuneration and working conditions, so that competent and able persons may like to stay in it. Not only that, the general manager must be given complete authority over the main business activities. The board of management, no doubt, can lay down broad policies, but
action with in these policies should be the domain of the manager. There should be no interference by individual members of the board in any of these areas.

Urban co-op. Banks have also not been able to create confidence in the general public. Firstly, these banks take unduly long time in giving loans etc.; and secondly, their managers are not quick, but they are indulge in serious malpractices. It's, therefore, necessary that sound leadership is developed and banks are made to provide the services of dedicated persons. Banks need intensive training as is being organised by the committee for co-operative training for other types of co-operatives.

The management of urban co-operative banks is a little more complicated than other banks since it involves looking after business matters, arranging credit and also facing political interference (Specially in Uttar Pradesh) etc. The importance of improving the management structure of these banks can not be over emphasised and the problem is indeed serious.

The supervision of the primary co-operative banks by the NABARD has also not been upto the mark. NABARD do not have an adequate policies for this purpose in most of the states (Specially in U.P.). Consequently, they have not been able to keep a watch on the functioning of the primary banks and guide their policies. The primary co-operative Banks, in the absence of efficient and trained staff, have to depend in some other banks. Lack of co-ordination between senior and Junior employees is also a big problem. Because of inconsistency of management, large number of Banks in U.P. is facing the problem of NPAs (non performing assets).
Arguments have been put forward from time to time at various conferences and committees and by various experts of Management for strengthening the urban co-operative banks department and for equipping the management/managers with greater powers. The urban banks department should be fully and completely equipped with adequate and right type of personnel, not only for discharging its present duties but also for undertaking the increased responsibilities envisaged for it by the experts.

In other states except U.P., Urban bank's management is showing a dynamic discipline as it mostly deals with ever-changing work settings characterised by people having varied backgrounds-cultural, social and religious-diverse goals and multifarious expectations, aspirations and attitudes. Moreover, the personnel scene has been changing quite dramatically over the years. Various factors in the external environment, such as unionisation of employees, government regulations and competitive pressures do exert a strong influence on the way the bank's HRM function is carried out in various areas. Further the nature of the work goals, makeup of the work group, leader's style and experience also determine the effectiveness of the HRM function in the long run. Over the years, employees of some state's banks have become more sophisticated in their demands for high quality work environments, Appropriate compensation and adequate training and development.

POOR RETURN ON STATUTARY INVESTMENTS

Unfortunately for urban banks in Uttar Pradesh, reliable and latest data on returns from statutory investments in various securities is not very easily available. Similarly, data on risk measures (like the Standard deviation of returns from specific securities, beta values of specific securities or covariance of returns from various securities)
which are compiled and published regularly by public sector agencies for their own markets, are non-existent in this state. Such data, if available, would have helped fund managers of banks to take better informed decisions. For example, to build a low-risk portfolio a fund manager, if the data were available to him, could have gone around choosing securities with a low or negative correlation between their returns. Similarly, reliable data on individual securities returns would help a fund manager choose securities which maximise portfolio return.

A large number of schemes floated by urban banks in U.P. and in other states are income-oriented and they invariably guarantee a minimum rate of return. We have also studied that as a result of this, the investment portfolios of most urban banks are heavily weighted towards corporate debentures which are typically available at a discount (i.e. at a price lower than the face value) and which therefore yield high effective rate of return. For example, if a debenture of Rs. 100 with a coupon rate (i.e. the rate of interest payable by the issuing company to the holder of the debenture) of 14% per annum is available in the market for Rs. 90 then the effective rate of return to the buyer of the debenture in \( \frac{14}{90} \times 100 = 14.44\% \).

There are however certain problems associated with investment in PSU’s debentures -

**Default Risk** - investing in PSU debentures exposes the bank to the risk that, issuer (the company which has issued the debentures) may be untimely in interest and principal repayments and/or may default in these payments. This may make it difficult for the Bank to achieve its stated objectives.
It is to state the obvious that the Government loan would have zero risk since the Government system does not fail and interest payments as well as principal repayments are absolutely assured but in case of U.P. the condition is just opposite because there is no stable Government and interference of politics in urban banks is increasing day by day.

The banks should not undertake any transaction on behalf of portfolio management scheme (PMS) clients in their fiduciary capacity, and on behalf of other clients, either as custodians of their investments or purely as their agents. The banks are prohibited with immediate effect from undertaking ready-forwards or double-ready forward or in any other securities, such as public sector undertaking (PSU) bonds and units. Inter bank ready forward transaction in treasury Bills are however permitted.

A very generalised conception of risk has its origin in decision-making, which, in turn relates to some future time period. A decision would be centred on some event whose future outcome would not be, perfectly predictable. Such a situation creates condition or risk. Availability of prior information about future is critical for rational decisions. Three situations can be broadly identified. On one extreme is the availability of complete fore-knowledge. The case of sure knowledge is known as a situation of certainty. The other extreme is a case of no knowledge at all. This is recognised as "Uncertainty". What lies between the two extremes is all the risk zone. A bank has to grapple with this Zone most of the time.

Two elements in the concept of risk as applied to the urban banks investments deserve attention. One, risk in the investment sense is associated with return. A bank buy a Statutory asset with
expectations of a good return. The investment decision would be premised on an "Expected return" which may or may not actually be realised. The chance of an "Unexpected" or "adverse" return would be the risk carried by an investment decision.

ISSUES & SUGGESTIONS
- There is a need to setting up a separate regulator for the UCBs are currently regulated by three Authorities - The central and state governments, apart from the RBI.
- There should be a new apex supervisory body which can take over the entire inspection and supervisory function in relation to schedules and non scheduled UCBs.
- Researcher feels that the apex supervisory body could be under the control of a separate high-level supervisory board consisting of representative of the central Government, State Government, the RBI as well as experts.
- The Role of the proposed apex body would to ensure that banks conform with prudential, capital adequacy and risk-management norms laid down by RBI.
- RBI should be prepared to provide all the necessary manpower and other assistance to the new apex supervisory body.
- Most of the bankers of Cooperative Sector may feel that this will add to the list of regulators. "All ready the system is facing problems with dual regulations, having another apex body that will supervise the implementation of regulation laid down by the Reserve Bank will only add to manipulation in the system. But according to researcher all financial intermediaries should come under one regulator for effective functioning of the system. It has pointed and that since there are large number of cooperative banks with their dispersed and local character". Their Supervision and inspection pose special problems.
At present State Govt. is required to audit the accounts of UCBs and there has been substantial delay in completing audit of a large number of UCBs.

Note: (I) The RBI conducts statutory inspections normally once in two years in respect of scheduled UCBs, once in two to identified weak banks are inspected on annual basis.

(II) A paper on Problems of Urban Cooperative Banks & Credit Societies states that in RBI's decision to raise the limit to Rs. 100 crore will destroy the aspirations of several co-op. banks to achieve scheduled status.

(III) Regarding the issue of licences to existing banks, the note states that several unlicensed banks have been denied licences for a long time as they could not fulfil the viability norms prescribed by the regulator. The standard was revised every time the banks achieved the desired norms, as a result "delay becomes a perpetual factor".

- It is suggested that unlicensed banks be divided into two categories-- those identified as weak due to heavy erosion and/or high overdues and those which have failed to comply with other statutory requirements.

- Banks which have "reasonable" prospects of overcoming weaknesses within a period of five years should be allowed to function with a time-bound action programme under direct guidance and control of a specially constituted RBI panel. In all other cases, banks should be allowed to function independently and merger/amalgamation/liquidation is advisable.
- "Rehabilitation of weak banks should be the primary responsibility of the RBI," and instead of transferring it to the registrar of cooperative societies, the RBI should prepare rehabilitation schemes similar to those drawn up by the Board for Industrial & Financial Reconstruction (BIFR).

- Urban banks should extend their area of working on the basis of fixed target, it may be yearly, half yearly, & quarterly.

- They should adopt new Technology and should give priority to their customers.

- There should be a proper survey of staff and officers.

- They can adopt the trend of "Associates" like ICICI etc. for loan financing.

- They can change their look by proper sitting arrangements, Good lighting, Efficient and well behaved staff.

- They should take strict step towards statutory investments and should deal it like other customers.

Researchers hope that the above mentioned suggestions may be fruitful for the urban cooperative banks of Uttar Pradesh and will increase their profitability.