CHAPTER 1 – OVERVIEW ABOUT THE TOPIC

Banking sector has been defined in many ways: Nationalized, Private sector, Foreign and Co-operative. Here we have taken a topic on co-operative sector; particularly Urban Co-op Banks as this entity has no government support hence they have to adhere to all the rules and regulations of govt. and central bank of India. Despite of this the role played by urban banks is very well; particularly for the Aam Aadmi and for the unbanked area of the country. Reserve Bank Of India has put these banks as tier I and tier II banks for their regulatory purpose we have taken this norms to our topic as Tier II urban banks as these banks are falling under the > 100 cr. deposit criteria. If we take performance evaluation regarding deposits and advances of these banks it will be definitely fruitful to the common man and mass to the small depositors who always prefer to bank with such bank. The circular regarding tier I and tier II is as follows:
Meaning and Definitions of Tier I and Tier II Urban Banks:

**RBI/2007-2008/259**
UBD (PCB).Cir.No.35 /09.20.001/07-08
March 7, 2008
The Chief Executives of
all Primary (Urban) Cooperative Banks
Dear Sir/Madam,

Classification of UCBs for Regulatory Purposes - Revised Norms
As you are aware, banks are being categorized for regulatory purposes as under:
(a) **Tier I Banks:** Unit banks i.e. banks having a single branch / HO with deposits up to Rs. 100 crore and banks having multiple branches within a single district with deposits up to Rs. 100 crore
(b) **Tier II Banks:** All other banks.

2. Based on the representations received from the UCB sector, it has been decided to amend the definition of Tier I banks and accordingly banks may be classified in Tier I category for regulatory purposes as under:
(a) **Tier I Banks:**
   i) Unit banks i.e. banks having a single branch / Head Office and banks with deposits below Rs. 100 crore, whose branches are located in a single district.
   ii) Banks with deposits below Rs. 100 crore having branches in more than one district, provided the branches are in contiguous districts and deposits and advances of branches in one district separately constitute at least 95% of the total deposits and advances respectively of the bank.
   iii) Banks with deposits below Rs. 100 crore, whose branches were originally in a single district but subsequently, became multi-district due to reorganization of the district.
(b) **Tier II Banks:** All other banks.

As hitherto, the deposit base of Rs. 100 crore will be determined on the basis of average of the fortnightly Net Demand and Time Liabilities in the financial year concerned. Similarly, advances will be determined on the basis of fortnightly average in the financial year concerned.

3. The revised instructions shall be applicable with immediate effect.

Yours faithfully,
(A.K Khound)
Chief General Manager

Figure 1.1
1.1 IMPORTANCE OF PERFORMANCE EVALUATION

After 1991 the total baking sector in India become highly volatile the international standard become more sticker and after introducing Basel I norms every bank in India have to follow minimum 9% CRAR. Moreover RBI has also emphasis on deregulation of major norms...At the same time the cooperative sector has also facing difficulties only due to their restricted area of operation and limited resources. RBI has also divided urban banks in tier I and tier II banks for their regulatory purpose. After MCMB Scam more than three hundred cooperative banks had suffered. Many depositors have lost their deposit and distrust aroused among cooperative banks. RBI has also introduced a Vision Documents and made MOU with respective state government to maintain confidence of customer of cooperative banks.

When we think about banks, every one think about its deposits and advances and financial soundness of banks. It is obvious that if a big bank fails large number of customers have badly affected. So whenever we want to relation with bank we have to consider their soundness by evaluation of performance we can arrive at our conclusion, here we take tier II urban banks as they category put deposit over 100 crores...we know the deposit is a basic raw materials to the banks, if deposit is large than working of that bank is also high, they have to consider each and every segment of the banking i.e. advances, investments, other income and other services.

Types of deposit:

- Savings deposit
- Current deposit
- Term deposit
1st two deposit generally consider as low cost deposit where as term deposit bears interest. Every bank nowadays tries to increase their low cost deposit. Low cost deposit has direct relation with the profit, if bank have huge low cost deposit than their profit will definitely increase. Earlier co.op.bank gave 0.5% interest on current deposit but later on RBI has withdrawn, recently RBI has increased interest rate on savings deposit and but the bank is free to decide above Rs.1 lakh deposit in the savings account; moreover calculation of interest on savings is made on daily basis. Requirement of statutory provision are made by banks on the basis of their NDTL which also is a form of total deposit.

The main function of bank is to accept the deposit for the purpose of lending and investment, so loan and advances and investment is also a main part of the study before highlight on loans we must know the principal of sound lending as one cannot put all eggs in one basket.

1.2 PRINCIPLES OF SOUND LENDING:

There are some specific principles, which the banker has to follow while scrutinizing the loan applications. These principles have been clearly laid down by ‘the Gujarat Urban co-operative banks Federation.’ They are explained below.

SECURITY:

Security is the prime consideration for the bank in lending advances to the entrepreneurs. When the bank is lending, it should be assured of recovering of its money with interest. If the borrower is dishonest or makes huge losses in his business due to his inability, the recovery of loan becomes difficult. Bank should, before granting loan, make it sure that the money is advanced to the proper person and he is going to utilize that money in such a way that he will be able to repay the loan with interest at the end of the term of his loan.
LIQUIDITY:

It is not enough that the loan is repaid but it should also be considered that the amt. of loan, as and when required, is repaid in time and according to the provision of contract of loan. In short the borrower should be able to repay the loan whenever he is asked for within stipulated time. It is possible only when the borrower deploys his money for meeting his short-term requirements. If he invests borrowed money in any fixed assets or any schemes, which involve long time to repay, it becomes difficult for him to repay in time. The means of borrower to repay the loan should also be definite.

PURPOSE:

Purpose of loan must be business or profession oriented so that it can provide for adequate means to repay and security of loan. Purpose of lending should be of short-term considering the liquidity factors. Bank does not advance for the purpose of storage of goods in huge quantity or for gambling or trading in sock market. Bank should properly check and if possible, assure that borrower is using the money for the purpose of which they have been borrowed. Bank also discourages advances for the social purpose like traveling or to repay old debts. In some special cases, with due consideration, bank advances small amt. for meeting personal expenditures or for meeting short-term requirement.

PROFITABILITY:

Bank should also make profits like other business organizations. Bank has also to pay interest on the deposit collected; besides provisions have also to be made for cash expenses like rent, stationary, maintainers, and non cash expenditure like depreciation and bad debt reserve. After meeting all these expenses for administration, bank has to make net profits. If bank can’t make adequate profits, it can’t increase its reserve and can’t pay dividend to its shareholders.
Considering all these things, bank rates are also affected by policies of the reserve bank and other factors like reputation of borrower, type of securities and mortgages, type of advance etc.

**MORTGAGE SECURITY:**

It is the trend of banks that not to grant advances without any securities or mortgages. Mortgages are considered to be insurance in times of crisis. Bank carefully assess various aspects of securities before granting advances and makes provisions against any advances effect on the liquidity of lending due to any drastic change in the economy so that it can recover its advanced money from the security in case the means of repaying fails. Bank should also consider the quality of term of lending. This adequately consists of liquidity, profitability, purpose etc.

**VARIETY OF LENDING:**

Another important principle of good lending is variety of lending. Every lending involves element of risk. In fact the banking business is a business of dealing in calculated risk. Risk of lending may be reduced to some extent if the total lending is spread over various areas of economy. Ex. If the major amt. of deposit are deployed in some particular type of lending or security, and if there is drastic draught in the prices of that security or depression in that particular area of business, there is a risk of huge backing of funds.

**IDEAL LENDING:**

It is the ideal lending which is made to reliable customer for approved purpose, in which banker and customer has enough experience and if assured that the amt. of loan is going to be utilized in a profitable way and will be repaid in stipulated time or on maturity date.
1.3 FUNDAMENTAL QUESTIONS

The bank manager when faced with request for the credit must obtain all the necessary information from the applicant to be the three basic questions.

- Who is our borrower?
- What is his requirement?
- How he will repay?

Who is our borrower?

There is only highly variable factor in lending propositions: the customer. Lending is essentially to the person and this is obviously so in a transaction with a personal customer, but with business lending it may seems that the structure and prospect of the business it self are all important. Of course, the detailed of the lending propositions are vital and the structure of the business must be examined. When dealing with loan applications the integrity and honesty of the person or people involved is the first factor to be evaluated. Repayment is in their hands. The questions arise: whether it is entrust the banks money to this person or those people? The answer to this question is to be found in a composite of ‘five Cs’.

Character:

Honesty is obviously and essential quality when it comes to dealing in financial matter and it important that the banker discards any proposition when he is not entirely satisfied that the prospective customer is trustworthy. It is unwise to not entirely that a person previously found to be untrustworthy will change his charge his character when coming a fresh to the bank for an advise. On the other hand, a person who is really honest will rarely change whatever the
testing factors. So, the character, in other words ‘honesty’ is the best of all security for bank advances.

Capacity:

The capacity of a borrower refers to his ability to run the business in a profitable manner, and to his qualification and experience in the line of business. The manager must decides whether the borrowing customers have sufficient time and hard work to ensure the success of the business, for the repayment of a borrowing. The customer must have technological knowledge in his own field.

Capital:

By putting his own money in to the business, the borrower has his own stake in the business, i.e. he takes a part of the risk in business. Normally, a borrower brings his part of a money whenever a applies for a lone from the bank and goes under the stipulation of margin in even loan. However in advances to weaker sections and in many other genuine cases, margin is not insisted upon and the entire capital is financed by banks.

Collateral:

Most of the bank shows the credibility of the customer, purpose for loan and repayment capability of customer when lending loan. Banks check all documents and also taking information from market about the person. After checking all documents bank makes the report. This report is present over lending committee of bank and board of directors.
Most important factor is it should be MAST security. MAST security means:

M = Marketability
A = Accessibility
S = Storability
T = Transferability

Condition:

In a bank it must by a customer to follow all the conditions. Generally in bank all the condition are indicated, but some basic condition which customer must have to follow and some are hidden by bank but these condition are also follow by the customer.

What are his requirements:

The amount should be need-based sufficient to meet the borrowers for the required purpose. Obviously, it must always be appropriate to the resources of the borrowers and his ability to repay. If a borrower has a reasonable amount of his own invested in the project, he will have the incentive to make it a success. It is usually unrealistic for the risk should be borne by the customer for the project he feels is sound.

Although no hard and fast rules can be laid down, if is often though that the bank should not invest more business or project than the customer. The rule does not necessarily apply to the personal borrowing but some contribution from the customer is still required. In the case of advances to weaker section in the priority sector, the borrower’s contribution is not insisted upon and 100% bank finance is provided.
Loans should be neither overestimated nor underestimated as anything which is in the nature of under or over-finance would become as economic waste and difficult of recovery. If the banker takes the applicant at his words and merely ends the amount requested without further inquiry, he will many cases be forced to increase the advance within a short while to project may fail and the customer may be unable to repay the advance. Alternatively, if he felt was prudent. Therefore it is essential for the manager to look at the proposition, check any figures given and attempt to see that the bank advances will fit into the scheme and the amount asked for by the customer is sufficient for carrying out the project.

How he will repay?

To lend money is an easy matter. To be sure of the repayment and of making a profit in the process is not so easy. The principal ingredient in appraising a lending transaction is that instruct thing what we call ‘confidence’. A banker will lend money to customer only he has total confidence in customer’s intention and ability to service the loan in terms of regular interest payment and to repay the loan on due date. This confidence is made of money components. It is partly the part an appraisal of the customer’s experience and ability in a particular field of business; it is partly an assessment of the customer’s resources, and from the bank’s appraisal of the customer’s creditworthiness.

1.4 FOCUS ON LOANS AND ADVANCES

LOANS:

Loan is a method of lending under which bank gives credit to a borrower for a specific purpose. Many time a borrower for a fixed period and for a specific purpose. Many times a borrower needs fund
for fixed assets or non-repetitive type of activities and thus, seeks money from the bank which is withdrawn in one lump sum. If the borrower needs again funds for such purpose, he has to negotiate with the bank for a loan again or to get his existing loan renewed. The loan amount is normally repaid in installments. Loan may be short-term, medium-term or long-term. Long-term loans are generally taken for meeting the capital investment requirements. Such loans are also called "Term loans". When a loan is meant for meeting both fixed capital and working capital requirement of a borrower, it is called a composite loan.

Co-operative banks offer different kinds of facilities to their customer for various purposes and these may taken the form of loans, overdraft, cash credit, bills purchased and discounted letter or credit, etc.

A loan account represents one way of lending money to a customer. When a loan is granted against security or otherwise, a separate loan account is opened and debited with the amount of the borrower either in cash or by credit to his account. The only transaction in a loan account will be the original loan, credit by way of part repayment and debited by way of interest and other charges such as incidental charges, insurance charges or expenses to protect the security.

No other operation is allowed on a loan account by cheque or otherwise a when part payments are made, no amount can be withdrawn even if it is a part of repaid amount. Interest is calculated on daily balances of the loan account and debited at quarterly rests. Interest payable on the account balance even through the customer's current may have a credit balance. To this extent, loans account borrowing is more costly than an overdraft. Loan may be short-term and medium-term.
Generally loans, overdraft and cash credit accounts are repayable on demand and reviewed once a year, so that they are often regarded as relatively short-term finance. This does not suit the borrower and business that is seeking finance for an expansion and developments plan lasting over several years. Banks to meet this kind of requirements provide medium-term loan. Interest is calculated on the amount of the medium-term loans day to day basis on quarterly rests. Repayments are fairly flexible and agreed to suit the customer's requirements, either at even rate during the period of the loan or to coincide with the receipt of cash benefit flowing in the business from the assets purchased with an aid of loan. The big advantage for a business taking out such loans is that finance will always be available to the agreed period and cannot be recalled as a result of restriction imposed on bank lending or other interventions.

A loan account, as opposed to overdrafts, is especially appropriate where a customer, particularly customer, wishes to buy plant and machinery or some vehicles with repayments in stipulated installment and the bank manager find that loan flow benefits from purchasing new assets are not being received. The danger signals would be perceived early, and the matter taken up with the customer. Security is always needed to back a medium-term loan account.

As a part of credit policy to promote extension of small loans to borrower of small means, a number of special schemes are available with public sector banks to provide term loans. All these schemes are available with public sector banks to provide term loans. All these schemes are backed by the small loans credit guaranteed schemes and small loans guarantee schemes of the deposit insurance and credit guarantee co-operation, in the part of the bank lending is guaranteed to be repaid in the event of defaults by the borrower. Life insurance for the borrower may be included in the package so that, in the event of early death, the amount of the loan outstanding would be cleared.
**Advantage of Loan:**

1. **Financial discipline on the borrower:**

   As the time of the repayment of the loan or its installments is fixed in advance, this system ensures a greater of self-discipline on the borrower as compared to the cash credit system.

2. **Periodic Review of Local Account:**

   Wherever any loan is granted or its renewal is sanctioned the banker gets an opportunity of automatically reviewing the loan account. Unsatisfactory loan account may be discounted at the discretion of the banker.

3. **Profitability**

   The system is comparatively simple. Interest accrues to the bank on the entire amount lent to a customer.

**Drawbacks:**

1. **Every time a loan is required, it is to be negotiated with the banker. To avoid it, borrower may borrow in excess of their exact requirement to provide for any contingency.**

2. **Banks do not have control over the use of funds borrowed by the customer. However, bank insists on hypothecation of the asset/vehicle purchase with loan amount.**

3. **Though the bank loans are for fixed periods, but in practice they roll over, i.e. they are renewed frequently.**

4. **Loan documentation is more comprehensive as compared to each credit system.**
TYPES OF LOAN:

Banks grants loans for different periods- short, medium and long and for different purpose, broadly, the loans granted are classified as below:

- **Short Term Loan:**
- **Medium and Long Term Loan:**
- **Bridge Composite Loan:**
- **Consumption Loan:**

1) **Short Term Loan:**

Short Term Loans are granted to meet the working capital needs of borrowers. These loans are granted against the security intangible assets-mainly the movable assets like good and commodities, shares, debenture etc.

2) **Term Loan:**

Medium and Long Term Loan are usually called 'Term Loan'. These loans are granted for more than a year and are for expansion or diversification of an existing' unit. Banks grant such loans together with specialize financial institution.

3) **Consumption Loan:**

Though normally banks provide loan for productivity purpose only, but as an exception loans are also granted on limited scale-to meet the medical needs or the educational expenses or expenses relating to marriages and other social ceremonies, etc. of the needy persons. Such loans are called Consumption loan.

**Features of Term Loan:**

Term loan represents long term with a maturity of more than one year. They are obtained from banks and specially created financial
institution in India by private placement rather than subscription as is the case with most debentures issues. The purpose of term loan is mostly to finance the company's capital expenditures. Term loan have number of basic features. They are as follows.

I. Maturity:

II. Direct negotiation:

III. Security:

IV. Restrictive covenants:

V. Convertibility:

VI. Repayment schedule:

ADVANCES:

All the function of the modern bank, lending of funds with or without security is by far the most important function. A study of balance sheets as on 31st December 1969 of the first six banks of India, Punjab National Bank, Bank - of Baroda and United Commercial Bank reveals that about 80% of their revenues arise from interest and discount that is to sag, income derived from advances including Bills discounted and Bills Purchase, and interest on investments. Advances comprises large portion of a bank's total assets, and from the bank born of the bank's structure. The strength of company is thus primarily judge by the regarded to advances. A wise and product policy in regard to advances in considered on important factor inspiring confidence in the depositors and prospective customer of a bank.

Bank Advances Assist Economic Development:

Advances play an important part in gross earnings and net profit of co operative bank and also promote the economic development of the country. If your advance is not sound or your investment is not
proper it will definitely affects your existence and your trust among customer too.

Evaluation of tier II urban banks is an important aspect of the present scenario as After Madhavpura scam many small banks and customers have suffered a lot. South Gujarat is a place where many Co. Operative banks work by the people, for the people and of the people’s rules. This is why the RBI puts many restrictions to strengthen this sector and to regain the confidence of small depositors and shareholders of the co operative banks. Only eight tier II urban banks are working in south Gujarat today, so evaluation of these banks is necessary, not only in terms of their age but also their working.