Chapter - 6

Conclusions

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Suggestions
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It is clear from the study that performance of Indian banking sector after adopting the reforms in the early years have shown an overall progress in geographical and functional coverage but its operational efficiency remained unsatisfactory and characterized by low profitability growing non-performing assets and relatively low capital base. The external factors bearing profitability banking system related to high level of pre-emptions in the form of reserve requirements. The external factors in the term of reserve requirements administered structure of interest rates and credit allocation to certain sectors. Banking sector reforms were undertaken in order to promote a diversified efficient and competitive banking system. The thrust of the process has been to cut cost and raise the production efficiency-banking sector as a whole. The implementation of Narsimham Committee cause great strain on the performance of the banks but lately they are improving their over all performance in every critical areas but still it is not upto the global standard. In our
study we have examined that the first two years of deregulation nationalized banks profitability was severely impacted by the new accounting and prudential norms and the consequent cleaning up of balance sheets. We use four financial ratios for comparison net profit/total assets, net interest income/total assets, intermediation cost/total assets and compute averages for each of these ratios for the entire period of 1995–2000 for Nationalized banks we find that nationalized banks performance not upto the mark. Nationalized banks do better only on the ratio of intermediation costs to total assets.

Further examination reveals other noteworthy developments in banking sector after reforms period are:-

(i) Financial regulation through statutory pre-emption has been lowered while stepping up prudential regulations at the same time.

(ii) Interest rates have been de-regulated allowing banks the freedom to determine deposit and lending rates. Currently on the deposit sides the
interest rate on saving deposit administered; whereas on the lending side, while sub-PLR lending has been permitted the maximum spread is restricted to 4% over the PLR of each bank and there is a ceiling of PLR on small loans upto Rs. 2 lacs.

(iii) Steps have been inflated to strengthen Nationalized banks through increasing their autonomy.

(iv) A set of micro-prudential measures have been stipulated to impart greater strength to the banking system and also ensure their safety and soundness with the declared objective of moving towards international best practices (capital adequacy norms, exposure links, recognition rules for NPAs, provisioning norms, accounting rules valuation norms etc.)

(v) Measures have also been taken to broaden the ownership base of Nationalized banks.
(vi) The banking system has also witnessed greater levels of transparency and standards of disclosure.

(vii) As the banking system has liberalized and become increasingly market-oriented the financial markets have been concurrently developed, while the conduct of monetary policy has been tailored to take into account the realities of the changing environment.

(viii) There has been considerable improvement in the profitability of the banking system measured in loans of operating and net profits.

Further in our study we have examined that during banking sector reforms there were lots of weaknesses are as follows:–

**Capital adequacy**

The prescription of capital adequacy ratio was suggested by the Narsimham’s Committee found that it a ready solution for acceptance by the regulatory authorities. The rationale behind the perception of
capital adequacy is that a bank may become distressed if it faces loan losses and it did not have adequate provisions to meet the same. In order to provide cushion against such sudden losses which the bank may not be able to meet, regulations all over the world have prescribed minimum level of capital relative to their total assets. The Basle in 1993 had agreed on a minimum capital asset ratio of 8% that has been accepted for implementation by the Indian regulations too. Some of the banks failed in USA and other countries despite reporting strong capital adequacy ratio therefore it is considered as an important indicator of the strength of any financial institution by regulations all over the world. In case of Indian Nationalized banks the Govt. acted as a pillar of confidence even though some banks reported loses after implementation of prudential norms, but the regulators have not released the capital level and instead have followed prudence in further increasing the same and widening its applicability. Besides increasing CRAR to 9%, the RBI has stipulated that banks investments in all securities including those outside SLR (statutory liquidity Ratio) should be assigned risk weighted of 2.5%
for market risk with effect from March 31, 2001. A related development is the “New capital adequacy Frame work” developed by the Basle committee under which a three-pillar approach is to be adopted. This includes minimum capital requirements supervisory review and market discipline. In our study we examined that due to burden of non-performing assets and lacking of a favorable recovery environment, the surplus generating capacity of nationalized banks has been nominal. Therefore, to a large measure the capital levels prescribed has not been achieved through infusion of capital in the banks by the govt. in this study we have observed that till March 99, the total re-capitalization in public sector banks has been over Rs. 20,000cr. (200 billion). When the banks try to raise fund from market of the banks have been able to top the market only few of the banks have been able to tap the market for equity while in other cases, augmenting capital has been through debt. The current poor valuation of bank stocks has further dampened the efforts of banks. Although some banks have still ventured to tap the market. From the above discussion we have observed that only few
nationalized banks could attain the capital adequacy ratio according to norms, which is about 9%, thus to meet the increasing capital requirements banks will have to increasingly depend upon their internal surplus which will be achieved through better performance and the short strategy. In the medium term strategy if banks have to sustain their performance and fill out more rigorous prudential regulatory prescriptions, significant improvements in the recovery climate and more operational autonomy will be required this only can restore the confidence of the market in bank Scripps.

**Interest Rate Deregulation**

In the area of interest on deposits/savings, there does not appear any systematic architecture of the interest rate structure. To substantiate, no defined time path or defined reconditions have been identified in the area of deregulation of saving bank rates. It is apparent that banks, especially public sector banks are not ready for this reforms since there is a potential for instability in the form of shifts in saving bank deposits between banks, depending on the interest rates that emerge.
Thus, this is essentially a structural issue and conditional on improvements in operational efficiency of the public sector banks rather than an overall interest rate issue in the macroeconomic sense. Furthermore, on the overall interest rate structure in the financial system, with different authorities setting different interest rates, it might impinge upon the signaling mechanism of the Bank Rate.

**Non-performing Assets:**

The improvement in the position regarding NPAs in nationalized banks is viewed as more superficial than real. The root problem is that there is a sizeable overhang component arising from the weak debt recovery processes, inadequate legal structure, weakness in underlying secrecy, inadequate risk management techniques, etc. Any solution to the overhang problem of large magnitude requires well-crafted medium to long-term actions, devoted to specific definition of goals and negotiation of the process rather than ad hoc approaches.
Operationally in nationalized banks it seems imprudent to treat all non-performing loans as a single 'catch-all' category. Broadly, they can be categorized as loans to agricultural sector, directed lending, loans to small enterprises and loans to corporate sector. Many of the directed loans are subsistence loans, where default rates are high and recovery prospects not bright. As regards loan from nationalized banks to agricultural borrowers, legal impediments often prove to be a challenging proposition to recover their dues. Loans to small enterprise become difficult to recover due to inordinate judicial delays. Even if court decrees can be obtained towards recovery, by the time the charge of the assets is taken, its realizable value is significantly diminished because of several reasons including depreciation of the asset, lack of borrowers cooperation, limited market value of the asset, with the concomitant effect that such decrees are not executed. As regards corporate loans, suits pending/referred to Board for Industrial and Financial Reconstruction leaves little headroom for nationalized banks to effect recovery. Inadequate corporate governance practices coupled with
problems of fixation of accountability leaves little maneuverability for banks towards an all-out recovery drive. With the environmental changes that are taking place, it seems that the credit portfolio of banks is becoming vulnerable and the issue of NPAs would need to be tackled head-on. NPLs is a bane to the system and one should be bold enough to bring out the true position/tackle in ruthlessly.

Directed Lending:

The issue of direct lending in nationalized banks is also an area of concern. In a developing economy with a democratic polity and a large section of the populace below poverty line, while the policies are to the left of center, the implementation somehow is to the right of center. For instance, despite the definitional changes for eligibility under priority sector lending that have been effected consistently, the share of priority sector advances in total non-food gross bank credit of scheduled commercial banks (SCBs) has come down from 40.3 per cent in December 1980 to 35.9 per cent in March 2001. The direct agricultural lending accounts of
all nationalized banks show a declining trend (2.13 crore in 1994 versus 1.59 crore in 2000). Although during 1993 to 1998, their credit-deposit (C-D) ratio has declined from 67 per cent to 44 per cent (42 per cent in 2001), the share of agricultural loans in total loans has come down from 52.4 per cent to 44.4 per cent during the corresponding period.

**Corporate Governance:**

Last, but not the least of the problem areas with nationalized banks is the weak corporate governance practices. It must be appreciated that the reforms process is only an enabling mechanism; leveraging it fully is possible only if the institutional players in the system are receptive to good governance. Good governance practices are a 'coping mechanism' for an institution. Lack of such mechanism can prove to be a major source of weakness among financial institutions and banks, in India.

To syncopate, the reforms process cannot be entirely painless. While there are achievements, there are pitfalls as well. What is important is to strike a
balance: tread a careful middle path between the ex-cathedra overzeal for intervention and a complacent belief in the ability of the banking system to self-rectify its deficiencies. This is because, in an ideal world, there is always a smattering of small disturbances every year or two to keep the authorities on their toes. The real world, however is often far divorced from idealism: long periods of tranquility with little or no financial disturbance, engender a sense of complacency which eventually culminate in periods of turmoil which contain several failures and the threat of many more. A constant challenge, therefore, remains for the authorities in identifying newer risks, eschewing harmful incentives and strengthening the banking sector to keep pace with changes in technology. Vigil is the eternal price of freedom, which includes economic freedom as well. The present effort is a humble attempt in that directions.
Case Study of Canara Bank

From the on-going discussion it is evident that overall performance even after adopting Narsimham’s committee findings could not be up to the mark of the Nationalized banks and the Canara Bank is not an exception. From our study and analysis it is clear that the performance of Canara bank during the period 1995–96 to 2000–2001 which indicates all-round improvement in its working after adopting the banking sector reforms. The volume of bank transactions tremendously high and so far proving top most performance among all nationalized banks. The bank has also achieved significant improvements in business and efficiency parameters. In this study we have observed that the deposit growth during the period (1996–2001) of Canara Bank is improved but does not show significant improvement. Business per employee is considered as an indicator of productivity level. In terms of this criteria Canara Bank improvement has been marginal from the other banks. Income and expenditure being the major determinants of profit volumes (gross)
assume significant in any performance analysis. As evident from our study Canara Bank registering a marginal growth and have maintained their market leadership during the year 1996–2001. One of the key indicators of profitability of banks relates to operating profits as a proportion of average working funds. The present study shows that Canara Bank stood among the top banks and show significant increase in net profit. In case of provision and contingencies Canara Bank register a negative growth in the given period. Quite significantly Canara Bank is found to be in maintaining their asset quality during 1996–2001. Net NPA ratio is significantly low as compared with the ratio for the other nationalized banks. The drop in NPA position has been owing to vigorous recovery efforts put in by the bank. Further study reveals that Canara Bank maintained its position on the top on high profit growth as well as volumes among the nationalized banks. It could be a judicious manpower mix, which has placed Canara Bank in the top bracket in terms of profit per employee. It is observed from our study that the capital adequacy ratio of Canara Bank is maintained during the period of
96–2001, with new norms on the anvil Canara Bank is placed on a sound footing as regards their capital adequacy ratio. Traditional banking has already undergone significant changes, with greater emphasis on business diversification and off-balance sheet and non-fund based activity has also cushioned the bank against sharp decline in interest spreads. Non-interest income to average working funds ratio indicates the exposure of a Banks to its non-fund based activities. In our study we find that the Canara Bank having ratios much higher than the same for other nationalized banks. Canara Bank also strengthens credit review and monitoring mechanism. Productivity as measured in terms of business per employee increases and bank recorded a growth in profit per employee. Canara bank is actively involve in rendering financial support to small-scale industries and weaker section of the society and minority communities. Apart from these, the bank also provided assistance to other priority sectors viz. retailers farmer self employed persons etc.
Weakness:

Apart from the above progress we observed that the bank having weaknesses in some areas. Some of its weaknesses are:

1. The improvement in the position regarding NPAs is viewed as more superficial than real. The RBI report on Trend and progress of banking 97–98 has revealed that gross non-performing assets (NPAs) of Nationalized banks has risen to Rs. 54700 crores as on March 31, 2001. At present most of the banks have 10–20% NPAs. That none of the Nationalized banks has been able to contain NPAs as per international standards at tolerable levels of around 3 to 4 percent and Canara Bank is not an exception, beside all the measures taken by Canara bank to control its NPA it still stands among these banks who are having large amount of NPAs.

2. Another serious weakness is in the area of ownership and control. The assisting and the continued government ownership has proved to be
problematic. While there was a merit in the nationalized bank model when it was adopted, a time has come for the government to review its position. Overlap of ownership and regulatory and supervisory functions forbearance with its attendant on financial stability.

3. Although Canara bank favourably placed in comparison with other banks deposit mobilization but still from our study we have find that Canara Bank have not been taking full advantage. Deposit mobilization shows that till recently the mobilization efforts lacked a sense of direction. The per employee deposit rate of Canara bank is inferior to the other banks.

4. Branches are the profit making windows are of the banks and the consolidated profit position of all branches primarily determines the profit of the banks. It has been observe that there are number of loss making branches in rural and semi urban areas of Canara Bank.
5. The capital adequacy norms are not made applicable uniformly though announced in India in 1992-93. To begin with all Indian Banks with international presence were asked to achieve a capital to risk weighted assets ratio (CRAR) of 8% by March 3, 1994. Other banks were asked to achieve 4% ratio by March 31, 1993 and 8% by March 31, 1996. The Canara Bank have a CRAR above the minimum (8%) and stood among those banks who require additional capital in the next five years.

6. Different types of deposits grew in all the population centres. But it appears from the facts and figures that the share of fixed deposits during the period mentioned did not show any significant variation in case of Canara Bank.

7. The world over, technology has been a major driving force of changes in the banking industry and it has modified completely the way in which banking is conducted. Extensive use of technology enables banks to satisfy customers' needs speedily.
and adequately. It improves the availability of information for management decision and for monitoring operations. Technology must be used to strengthen internal controls, improve the accuracy of records and provide new banking products and services viewed in relation to the technological progress made by banks abroad. Present status of Canara bank is not at all encouraging. The introduction of technological changes in Canara bank has been half hearted and sporadic, lack of direct involvement of the management, lack of resource planning and co-ordination, absence of vision and strong trade union resistance have been the major reasons for the poor progress of Canara bank on the technological front.

8. Interest rate risk management will pose a great challenge to banks in the year ahead. This has not received sufficient attention till recently as the rates were regulated by the Reserve bank of India. Deregulation of Interest rates on both deposits and advantages will result in higher volatility of Interest
rates. Even if the interest rates that move within a narrow band a situation of unstable interest rates is going to be a major problem in future and Canara bank is no exception.

SUGGESTIONS

Improving profitability and viability in only one aspect of enhancing the performance of banks. The other is how adequately and satisfactorily banks are able to meet the demands of customers. The ultimate test of success of the financial sector reforms is truly customer satisfaction, customer as a borrower and a depositor. Through the various reforms measures we are laying the foundation for an efficient and well-functioning banking system. Significant changes have already taken place. It has however still a long way to go. In the light of our study we have some suggestions are:

1. Ownership pattern of nationalized banks should be improved to achieve greater degree of autonomy on their operation than as at present, and full freedom available to the management to take major decisions.
2. Banks are to be more autonomous to raise capital from the market according to their needs.

3. Even though the level of NPAs have been steadily decreasing over the year, it still stands alarmingly high as compared to elsewhere. Reforming the Banking sector alone will not itself strengthen the banks. There is a dire need to speed up the entire recovery mechanism in the country.

4. India requires a legal system, which gives powers to the banks to immediately possess the current and fixed assets of the defaulters and sell them in the open market in case of defaulter do not arrange timely payment of dues.

5. Defaulters name should be made public.

6. Use of modern technology in banking is being increasingly seen as an essential ingredient as good customer service. The old manual systems on which the Indian banking has depended for centuries are unable to deliver the goods. About four decades of public sector banking has widened the banks branch
network and customer base to such gigantic proportions that the time tested manual systems of yesteryears are now buckling under the pressure of sheer volume and variety transactions. The service starved customers of the Indian banking system have, therefore, pinned their hopes on these banks to lead the way to introduction of modern technology in Indian banking. As the matter stands today, most of the foreign banks and all newly established private sector banks operating in India are fairly advanced in the use of technology. Most of their branches are fully computerized, many of them are equipped with ATM (Automated Teller Machine). As a result their customers are able to enjoy the following additional benefits –

(i) Statements of Accounts are neatly printed as against the illegible hand writing on the statements supplied by most of the nationalized banks.

(ii) Statements of accounts can be supplied at the desired frequency if needed, necessary
as against the currently prevailing practice of not providing any statements at all by all nationalized banks.

(iii) Even passbooks for saving Bank accounts can be neatly printed by a pass book printing machine hooked on to the computer system. A similar machine installed in the customer lobby can help the customers help themselves by updating their pass books merely by inserting the passbook in to the machine.

(iv) ATM, installed in every important corners of the city and they are inter and intra connected around the country.

In suggestion these facilities are now necessary to satisfy the customers. Nationalized banks should think over it seriously.

7. The CRR (Cash Reserve Ratio) is a heavy tax on the banking system and balances with the Reserve Bank, which earn no interest represent an indirect
tax on the bank depositors. Phased reduction in the CRR and its eventual withdrawal needs to be high on the agenda in coming years. This would ensure a more level playing field between banks and non–bank institutions and would enable banks to offer better rates to the depositors.

8. Bank merger should be considered as a possible avenue for improving the structure and efficiency of the banking industry.

9. Banking failure was observed in 1980, world over. The massive bank losses in industrial and developing countries during this period could be attributed to a plethora of reasons, such as poor asset quality, bad debt, sloppy management, speculation, economic scenario inefficiency, fraud, shocks from other markets excessive overheads asset liability and treasury mismatches excess taxes and regulation. Huge fiscal deficits were responsible in Argentina, Chile and Malaysia. In today globalize world, weakness in the financial system of any country which have an impact on
other countries also. East – Asian crises had led banking systems of other countries to a vulnerable position for some time. It is need of the time across the world are to monitored and supervised banks closely.

10. Indian banks have to concentrate on asset quality and earnings, which are determinant of internal capital generation. Profitability and risks management is two key aspects to assess financial performance of commercial banks. The performance of a bank will obviously be better with higher profitability and lower risk.