

Urban Cooperative Banks – An Introspection

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The current status of Urban Cooperative Banks (UCBs) is being discussed very widely today. In this connection, here are some observations for the consideration of people related with the UCBs. However, before that, let us have a look at some statistical data. The statistics will give an idea about the role played by UCB Sector in the Indian economy, particularly Indian Banking Sector.

As on 31st March 2006, there were 1,853 UCBs in the country (excluding 226 UCBs which were under liquidation). Out of these 1,853 UCBs, 1,479 UCBs (i.e. about 80% of the UCBs in the entire country) were concentrated in five states viz. Andhra Pradesh, Gujarat, Karnataka, Maharashtra and Tamil Nadu. Following tables gives the center-wise distribution of the UCBs.

Center	No.
Ahmedabad	296
Bangalore	297
Bhopal	75
Bhubaneshwar	14
Chandigarh	16
Chennai	132
Guwahati	18
Hyderabad	124
Jaipur	39
Jammu	4
Kolkata	51
Lucknow	77
Mumbai	456
Nagpur	174
New Delhi	15
Patna	5
Thiruvananthapuram	60
TOTAL	1853

Source – Report on Trend and Progress of Banking in India by RBI

For the last 3-4 years, Reserve Bank of India has been classifying the UCBs based upon the various grades viz. Grade I, Grade II, Grade III and Grade IV. UCBs falling under Grade III and Grade IV can be considered to be weak or sick. Out of these 1,853 UCBs, 677 UCBs (i.e. 37% of the UCBs in the entire country) were classified as Grade III or Grade IV. Following table gives the details of center-wise distribution of Grade III and Grade IV UCBs.

As on 31st March 2006, the deposits of the entire UCB Sector were Rs. 1,12,237 Crores, which accounts for about 5.19% of the total deposits of Scheduled Commercial Banks as on that date. As on 31st March 2006, the advances of the entire UCB Sector were Rs. 70,379 Crores, which accounts for about 4.64% of the total advances of Scheduled Commercial Banks. Following table gives the details of deposits and advances of the UCB sector on a comparative basis.

Particulars	Rs. in Crores	
	31.03.2005	31.03.2006
No. of UCBs	1,872	1,853
Deposits of UCBs – Rs.	1,05,021	1,12,237
Deposits of Scheduled Commercial Banks – Rs.	18,37,557	21,64,477
Advances of UCBs – Rs.	66,874	70,379
Advances of Scheduled Commercial Banks – Rs.	11,50,836	15,16,557

Source – Report on Trend and Progress of Banking in India by RBI

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Center	Grade				Total
	I	II	III	IV	
Ahmedabad	136	50	67	43	296
Bangalore	90	76	85	46	297
Bhopal	16	28	17	14	75
Bhubaneshwar	1	6	3	4	14
Chandigarh	10	1	1	4	16
Chennai	54	32	39	7	132
Gawhati	6	4	4	4	18
Hyderabad	48	43	18	15	124
Jaipur	25	10	3	1	39
Jammu	2	-	2	-	4
Kolkata	30	11	3	7	51
Lucknow	47	13	9	8	77
Mumbai	173	128	84	71	456
Nagpur	53	45	43	33	174
New Delhi	12	1	-	2	15
Patna	3	1	1	-	5
Thiruvananthapuram	10	11	28	11	60
TOTAL	716	460	407	270	1853

Source – Report on Trend and Progress of Banking in India by RBI

An alarming percentage of NPAs is often stated as one of the most serious cause of concern so far as the UCB sector is concerned. Following table indicates the percentage of Gross NPAs to Total Advances Outstanding.

Year ending on 31 st March	Percentage
2001	16.1
2002	21.9
2003	19.0
2004	22.7
2005	23.4
2006	19.7

Source – Report on Trend and Progress of Banking in India by RBI

Till about 2001, the UCB sector was doing well. Not many of the adverse remarks were being heard about the UCB sector. In fact, the UCB sector was being praised for the remarkable progress made by it. However, the things changed once the involvement of Madhavpura Cooperative Bank was unearthed in the scam committed by Ketan Parekh. The scam was followed by Home Trade scandal in which about 25 UCBs were involved. Irregularities in many UCBs came to the surface. Boards of many UCBs were superseded. UCBs in the country became the hot topic for discussion.

Last few years have witnessed remarkable changes in the Indian Banking Sector. The areas which were considered to be the turf for UCBs (viz. Personal Loans, Vehicle Loans, Housing Loans etc.) are being targeted by the commercial banks and private sector banks. During the time when UCBs needed to improve their performance drastically, they seem to be in trouble. This is the proper time to have some introspection about the UCB sector and what can be the probable solutions to improve the current status of the UCB sector. Before we talk about the current scenario in the UCB sector, let us consider the background of the UCB sector.

Bank promoted by a single or some limited number of influential people in a certain region or in a particular community is the real nature of an UCB. Doing the banking business and earning the profits on cooperative principles for the members is the basic objective of an UCB. Accepting the deposits from the depositors and lending the same on interest is the basic function of the UCB. Arbitrage between the interest payable on deposits & borrowings and interest earned on advances is the basic source of income for the UCB. However, what happens in reality?

- The principle of cooperation gets sidelined. UCBs in many cases is viewed and operated as the power center. Politicization of the UCBs is one of the major reasons for the problems in the UCB sector.

- It is very essential to remember that Banking is a business and that is very technical in nature. If one wants to run a bank profitably, he needs to do the business in an absolute professional manner. Lack of professionalism while doing the banking business is one of the major reasons why the UCB sector is in trouble today.
- In today's competitive environment, in order to attract the depositors, UCBs tend to accept the deposits at a higher rate of interest. If you want to pay higher interest on deposits, you have no alternative but to charge more interest on your advances or to lend the funds in sensitive sector which may give you higher rate of interest. If the UCB is going to charge more interest on advances, the borrowers having good credit standing and having alternative borrowing sources, will keep themselves away from the UCB sector. If the housing loan is available at the rate of interest of 7% or 8%, who is going to borrow the housing loan from a UCB by paying the interest of 12% or 13%. The UCB sector needs to remember this reality.
- Before disbursing the loan to the borrower, it is absolutely necessary to evaluate the credit standing of the borrower properly. However, in reality, relationship of the borrower with the promoters or directors plays a significant role. As such, there is laxity in evaluating the credit standing of the borrower. This results into increasing NPAs of the bank. An UCB cannot charge the interest on NPAs. This affects profits of the UCBs adversely, leading to non-payment of dividend. Increasing percentage of NPAs, which is essentially the outcome of indiscriminate lending made by the bank, is one of the major reasons for the sickness in the UCB sector.
- In case of many UCBs, which are in trouble, indiscriminate lending has been done to the directors or the relatives of the directors or the organizations in which they are interested. Many of such advances have become NPAs. Sufficient efforts are not made to recover these NPAs.
- Ideally, a loan proposal should get generated at the branch level and should come to the board for sanction. However, in reality, it is sanctioned at the board meeting first and is then passed on to the branch for execution.
- In many cases, due to the personal ambitions of the promoters or directors or with the intention to expand the bank, UCBs tend to accept the deposits at higher rates of interest. Unless these deposits are deployed profitably, the banking business may not become feasible. In today's circumstances when multiple options are available to the borrowers, finding the borrowers with good repayment capacity becomes problematic for all the banks, including UCBs.
- Lack of proper control mechanism, both internal as well as external, is one of the major contributing factors for the current status of the UCB sector.

Now, let us consider some of the basic facts about the UCB sector in the country –

- Duality of Control over the operations of Urban Cooperative Banks is the matter, which is being discussed for the last so many years. UCBs being basically the banks, banking related matters regulated by Reserve Bank of India and cooperation being the State subject, the administrative matters are regulated by State Governments through the Registrar of Cooperative Societies. In want of clear-cut segregation of the responsibilities between these two, this has resulted into overlapping jurisdiction of the state governments and RBI. Further, taking into consideration the number of UCBs in the country, it is proving to be difficult for RBI to supervise the UCB sector properly and effectively. Dr. Bimal Jalan, the then Governor of RBI, in his statement on Monetary and Credit Policy for the year 2001-2002, had mentioned about setting up of a new apex supervisory body to take over the entire gamut of inspection/supervisory functions in relation to the UCBs. He had suggested that this apex body might have the representatives of the RBI, Central Government, state governments and other experts from the field. The proposal is yet to see light of the day.
- Banking Regulation Act, 1949 was made applicable to Urban Cooperative Banks since 1st March 1966. An amendment bill was introduced in Lok Sabha on 12th August 2003 to make amendments to Banking Regulation Act, 1949. The bill was supposed to give more powers to Reserve Bank of India to regulate the affairs of UCBs. The promoters or directors of many UCBs were afraid of losing the control due to the amendment bill. As such, there was tremendous opposition from the UCB sector for introducing this bill in the Lok Sabha. The amendment is yet to see light of the day.
- One demand is consistently made from the UCB sector that they should not be compared with the private sector banks or commercial banks. To some extent, there is some substance in this demand. The kind of opportunities and facilities available to private sector banks and commercial banks are not available to UCB sector. However, the promoters and directors of UCBs need to remember that it is not possible to treat the UCBs differently from

other banks. After accepting the Basel Accord, it is obvious that the rules and regulations applicable to other banks are going to be equally applicable to UCBs.

- In 2005, Reserve Bank of India published a Vision Document for the UCBs. According to Vision Document, Reserve Bank of India will enter into the Memorandum of Understanding (MOU) with the State Governments. The MOU was supposed to give wide powers to RBI for the regulation of UCBs in the country. The people connected with UCBs need to remember that eight states have already entered into the MOU with RBI. These states are Andhra Pradesh, Gujarat, Karnataka, Madhya Pradesh, Uttaranchal, Rajasthan, Chhattisgarh, Goa and Maharashtra. As a result, almost 80% of the UCBs in the country will be closely regulated by RBI.
- Post-1991 period witnessed various reforms in the banking sector. Recommendations made by Narasimham Committee regarding various Prudential Norms and the implementation of the same is the outcome of these reforms. The recommendations made by Narasimham Committee were made applicable to commercial banks to begin with and they were supposed to be made applicable to the UCBs in the phased manner. Initially, the Prudential Norms were felt to be critical for the commercial banks as well. As such, the commercial banks were in losses initially. However, later on the Prudential Norms were digested by the commercial banks. Today, virtually all the commercial banks are in profits. Possibility that the Prudential Norms will be applicable to UCB sector one day or the other was not considered by UCB sector seriously. As such, when the norms were made applicable to UCB sector, the performance of the sector started getting affected adversely.

On this background, it is essential to see what the UCB sector has to say about the present scenario. In the light of present requirements regarding CRR and SLR, almost 30% of the deposits of UCBs are not available for lending. From the remaining 70%, which constitutes loanable funds available to the UCBs, 60% are to be lent to the priority sector. Effectively, an amount equivalent to about 30% of the deposits is available to the UCBs for lending the advances as per its own choice. And over and above the same, RBI is expecting the UCBs that the NPAs should be within the stipulated norms. It is a bit too much of expectation from the UCB sector. Directors of the UCBs are not the paid directors. The directors whose integrity is unquestionable, act as directors out of the feeling of social service. These directors may not be having qualifications or experience in banking business as envisaged by RBI. However, the very presence of these persons on the Board of Directors helps the UCBs grow. On this background, if the regulating authority is going to hold the directors entirely responsible for the unfavourable performance of the UCBs, that will demotivate prominent persons from offering themselves for directorship of the UCBs, which in turn will hamper the growth of the UCB sector. Accepting the fact that UCBs are primarily banks, none of the directors of UCBs will deny the role of regulating authority in exercising the control over the operations of UCBs. However, in the process, if the role of directors is going to get reduced to a meager proportion, they will withdraw their active involvement in the operations of UCBs, which again will hamper the growth of UCBs. Hence, to control the UCBs whose performance is not satisfactory entirely, appointment of an administrator may not be an ideal option available to the regulating authority. Not only that will defeat the democratic principle of UCBs, it will also create a grudge in the minds of directors against the regulating authority. Strong opposition to Banking Regulation (Amendment) and Miscellaneous Provisions Bill, 2003 and to the Vision Document issued by RBI for the UCBs is the outcome of this thinking only. However, UCB sector also needs to note that RBI has been successful in entering into the Memorandum of Understanding with the State Governments of major states. This fact is an indication that duality of control is here to stay with RBI having upper hand as compared to the Registrar of Cooperative Societies of the various states. It is in the interest of UCB sector that both the regulators operate in unison in the greater interest of the UCB sector.

In the recent past, particularly after the Home Trade scandal, UCB sector witnessed action being taken by the regulators against the UCBs. These actions were in the form of supersession of the Board of Directors, appointment of administrators, cancellation of banking license etc. In many cases, the performance of the UCBs was not so bad which called for the action being taken against them. The action was taken in a panic, after the involvement of these UCBs in the Home Trade scandal was unearthed. There are many UCBs whose performance is precarious. However, no action has been taken against them, either due to political or social reasons. Further, in many cases, the administrators appointed on these UCBs are the persons on deputation from the State Government and they are not necessarily having any banking background. As such, despite the fact that the administrators are in operation for a very long period of time, the financial performance of these UCBs has not improved. In fact in some cases, it has deteriorated in many cases. The UCB sector is wondering about this policy of the regulators.

Accepting the fact that UCBs are primarily banks, there is no point in comparing the UCBs with the commercial banks in totality. The fact remains that commercial banks have an edge over the UCBs, in terms of their size and area of operations, kind of business they can undertake, the sources and means available to them to do the banking business etc. If the prudential norms, which are applicable to commercial banks, are applied to UCB sector unilaterally, it may not be proper. When 180 days norm for identifying the NPAs was brought down to 90 days, UCB sector accepted the change, though with some reservations. However, if the norm is further going to be reduced to 30 days as being speculated in the UCB sector today, the UCB sector is afraid that the same will put an end to the cooperative movement so far as the cooperative banking is concerned.

Till the prudential norms were made applicable to the UCB sector, the UCBs were under the impression that everything is well. After the applicability of prudential norms, the UCBs have realized that they need to improve in various areas. However, what they need is the opportunity and time to improve.

In the light of above facts, the expectations of the UCB sector from the regulators are as follows –

- a. The regulator should not act as the regulator only. The UCB sector expects the regulator to act as their friend, philosopher and guide. Accepting the fact that all is not well with the UCB sector, UCBs expect the regulator to guide them as to where and how they have gone wrong so that the same mistakes do not get repeated in future. What the UCB sector is expecting is a chance to improve and if the UCBs do not improve their performance within the said time frame, they do not mind action being taken against them.
- b. The UCB sector expects the regulator to recognize the fundamental difference between the commercial banks and UCBs in terms of their size, area and nature of activities, infrastructure and means available to the UCB sector and above all the basic motive behind the operations of both. Hence, the UCB sector expects that the evaluation norms applicable to commercial banks should not be unilaterally applied to UCB sector. The evaluation norms need to be softer for the UCB sector.
- c. The UCB sector is expecting that while dealing with them, the regulator should take a humanitarian approach rather than taking a total technical approach. This will prevent the genuine persons from being punished for the misdeeds of the others. Hence, the expectation is that before initiating any action against anybody, more emphasis needs to be on in-depth study on case-to-case basis.

All said and done, the UCB sector and particularly the persons connected with the UCB sector in the capacity of promoters or directors need to realize certain facts as early as possible. Otherwise, the very existence of UCB sector is going to be in danger.

- “Banking” is a business like any other kind of business activity. Everybody connected with UCBs needs to keep in mind that in today’s competitive environment, where UCBs are facing fierce competition from other players in the banking sector and where the interest spread is getting curtailed to a large extent, it is imperative that the UCBs are run in a professional manner. Decisions based on personal and emotional basis may prove to be fatal. As rightly pointed out by Mr. Vepa Kamesan, Deputy Governor of Reserve Bank of India, “Paradoxical as it may sound, evolution of cooperatives in India as peoples’ organizations rather than business enterprises adopting professional managerial systems has hindered growth of professionalism in cooperatives and proved to be a neglected area in their evolution. The cooperative banks should indeed work like professional organizations on sound managerial systems in tune with the needs of the time taking care of future projections of requirements to retain and improve their market share and identity in the long run. It is in this context that professionalism and accountability of the bank’s boards assume such critical significance and introduction of corporate governance in the Urban Cooperative Banks would go long a way to promote their professionalism”.
- It is necessary that the UCBs realize their strong points and focus their business models around these strong points. If a certain business requires technical expertise, it will be ideal not to touch that business unless sufficient infrastructure is available to start and run that business successfully.
- Banking business is highly technical in nature. It is necessary that everyone at all the levels of management of the UCB, right from the members of board of directors to the employees working at the operational level, are aware of all the intricacies of the banking industry. As such, proper training programmes for all the levels of management should be organized on a continuous basis.
- If sufficient internal expertise is not available, help should be taken from the external consultants. Deficiencies not realized by the internal experts can be pointed out by the external consultant. In many cases, however, the

UCBs avoid to take the help of external consultants, as it proves to be a costly, and at times, politically inconvenient proposition. Everyone dealing with UCBs needs to realize that the implications of wrong financial decisions may not be realized immediately and by the time they are realized, it may be too late.

- Immediate action on the deficiencies pointed by various auditors or inspectors is a must. Deficiencies pointed out by the auditors or inspectors should be considered as an opportunity to improve your performance.
- Everyone dealing with the UCBs in the capacity of promoters or directors needs to remember that he is supposed to take only the strategic decisions in respect of the bank. Involvement of these people in the day-to-day functioning of the bank may prove to be a fatal proposition.
- As the UCBs are handling the public funds, it is obvious that they are going to be subjected to some kind of control. Whether the control is going to be of state authority or central authority, it should not be significant. If the UCBs inculcate the mentality to abide by the rules and regulations of whichever authority it may be, the problem of duality of control may not be important. The promoters and directors of the UCBs need to remember that any action being taken against their bank may put their credibility at stake.
- The management of UCBs needs to realize that Globalization and Liberalization is here to stay. In today's competitive environment, UCB sector is going to face fierce competition from not only the commercial banks, but also from foreign banks and private sector banks. The areas, which were conventionally considered to be the monopoly of the UCBs, are being tapped by other banks in a big way. Further, the interest spread is getting narrowed day by day. Other sources of income are limited for the UCBs. It is a high time that the UCBs realize that unless they are going to operate professionally, survival in the competitive environment will not be possible.
- Corporate Governance practices cannot be thrust upon anybody by making the changes in the law. Compliance with the corporate governance should be inculcated within the mindset of the management of the UCBs. A mere compliance with the legal requirements will not serve the purpose. Eg. According to the latest notification issued by RBI, every UCB is required to have atleast two directors having requisite professional experience in the field of banking and finance. In order to comply with this requirement, UCB appoints the directors on the Board of Directors. However, if the professional advice given by these directors is not properly utilized to improve the operational efficiency of the UCB, their presence on the Board of Directors will make no value addition.
- Recently, in one of his speeches, Mr. V. Leeladhar, Deputy Governor of RBI observed that "the real success of our financial sector reforms will however depend primarily on the organizational effectiveness of the banks, including cooperative banks, for which initiative will have to come from the banks themselves. It is for the cooperative banks themselves to build on the strategy inherent in the cooperative structure and stand up for their unique qualities. With elements of good corporate governance, sound investment policy, appropriate internal control systems, better credit risk management, focus on newly emerging business areas like micro finance, commitment to better customer service, adequate automation and proactive policies on house-keeping issues, cooperative banks will definitely be able to grapple with these challenges and convert them into opportunities".

To conclude, in today's competitive environment, survival of the UCB sector is going to be impossible unless they operate professionally. In one of his speeches, Mr. Leeladhar, Deputy Governor of Reserve Bank of India, has stated that slowly but steadily, we are moving from the regime of "large number of smaller banks" to "less number of larger banks". This statement can be taken as the indication of the thought process, which is going on in the field of UCB sector. Mergers and Acquisitions has become a popular word in connection with the UCB sector. Many cases of takeovers have been approved by RBI. Many other cases are likely to be approved in the near future. Unless the Urban Cooperative Banks improve their performance drastically, they will be left with no option but to close down their operations or get merged with some stronger banks. Hence, this is the last warning to the Urban Cooperative Banks.

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