SPEECH

INAUGURAL ADDRESS*

C. Rangarajan

It gives me great pleasure to be in Ahmedabad this morning and preside over the inauguration of the UTI Bank Ltd. UTI Bank Ltd. was among the first three of the nine applicants who have got RBI's in-principle approval under the January 1993 guidelines for the entry of new banks. I am happy, that UTI Bank Ltd. has taken the lead in commencing operations.

2. The entry of new banks should be viewed in the context of the reform programme launched nearly two years ago which is aimed at bringing about greater structural flexibility in the financial sector. A medium term strategy has been put in place to restore the financial and operational health of the Indian banking system and to improve its overall viability, efficiency and productivity.

3. This is not to say that the Indian financial system has not grown all these years. In fact, the Indian financial structure is now fairly diversified and caters to the financial needs of different sectors of the economy. The diversification is well reflected in the impressive network of banks and financial institutions, including specialised institutions and a wide range of financial instruments. Commercial banking activity spans several of the emerging business areas, such as, merchant and investment banking, leasing, factoring, venture capital, mutual funds, custodial services and a broad spectrum of financial and advisory services. Considerable expansion has also occurred in terms of the total number of commercial bank offices and rural branches. The commercial banks have their presence in the most remote parts of the country. The average population per bank office has declined from 65,000 in 1969 to about 11,000 in March 1993. The growth of the Indian financial system is also evident from the trends observable in the financial development ratios and flow of funds accounts which are indicative of the rapid growth of the financial sector, increasing institutionalisation of saving and growing separation of saving-investment functions of economic units.

4. While over the last four decades, the system has demonstrated its ability for mobilising saving and meeting the needs of the deficit sector, several stresses have also become evident. The system has come to be characterised by costly intermediation, low profitability and deterioration of portfolio. These weaknesses have resulted both, from government policies and nature of financial regulations and structural features embedded in the banking system.

5. The current attempt thus is to put in place durable structural changes in the financial sector which enhance the efficiency of resource use and help support the activities in the real sector. The major policy thrust is to improve the operational and allocative efficiency of the banking sector by focusing on *five* objectives: i) Correcting and improving the macro-economic policy setting within which banks operate, by rationalising interest rates and bringing down the levels of resource pre- emptions in the form of CRR and SLR. ii) Improving the financial health and condition of banks, by recapitalising banks, restructuring the weaker ones and improving the incentives under which banks function. iii) Building financial institutions and infrastructure relating to supervision, audit, technology and legal framework. iv) Improving the level of managerial competence and the quality of human resources by reviewing the policies relating to recruitment, training, placement, etc. v) Injection of greater element of competitiveness in the financial system. It is this objective which has led to the decision to license new banks.

* Address by Dr. C. Rangarajan, Governor at the inauguration of UTI Bank Limited at Ahmedabad on April 2, 1994.

6. Underlying this process has been the prescription of prudential norms and regulations, directed to ensure the safety and soundness of the financial system and bring about greater transparency and accountability in operations and restoring the credibility of and confidence in the Indian financial system,. Most significantly, however, prudential norms and ratios are aimed at: (a) bringing out the true position of a bank's loan portfolio, in terms of a proper recognition of the extent of loan impairment in the bank's balance sheet and the provisions charged against the bank's net worth under the newly prescribed regulatory and prudential norms relating to income recognition and accounting and provisioning; and (b) help arrest its deterioration.

7. Portfolio clean up and recapitalisation of the existing banks have to go hand in hand with necessary institutional and management changes in order to foster a healthy and competitive banking system. Towards this end, *three* steps have been taken. The *first* pertains to allowing public sector banks to raise capital from the market and meet their capital needs. In this way, public sector banks can raise fresh equity from the market while maintaining Government's majority ownership. This would lead to the 'corporatisation' of the existing banks, and allow them to issue shares in the market as part of the recapitalisation effort. While the State Bank under its existing Act, has already gone to the market, suitable legislative changes are required for the nationalised banks also to access the capital market.

8. The *second* significant measure deals with the allowing of direct private sector investment in the banking sector through entry and expansion. The entry of new institutions will provide a healthy measure of competition and serve as an important vehicle for introducing more modern methods and techniques. Foreign and NRI equity participation is also being permitted in the banking and financial sector. The Banking Regulation Act has been amended so as to enable banks to appoint a non-executive part-time chairman and a full time Managing Director and relax the restriction on voting rights from the existing one per cent to ten per cent of total voting rights.

9. The *third* measure to improve the competitive character is by granting more operational freedom to banks through liberalisation of lending norms and lending arrangements.

10. Sufficient care has been taken to see that entry of new banks takes place within a set prudential framework which includes adequate capital and proven technical and professional capacity to manage the bank safely and soundly. It has also been ensured that connected lending practices, concentration of credit, cross- holding with industrial groups, etc. are not engaged in. Adequate safeguards are in place to maintain an arm's length between the promoting institution and the bank. Insistence on the new banks meeting the priority sector lending targets and other social obligations is in-keeping with the principle of creating a level playing field for all banks. The regulators will be closely watching the manner in which new banks conduct their operations.

11. Indeed, the new banks will have some distinct advantages over the existing banks. They will be commencing their operations with a higher start-up capital as compared to several of the existing banks. They will also have the advantage of lower reserve requirements. Their rates of return will be considerably higher. Additionally, they would not have any non-performing assets or backlog of provisioning requirements and would operate with low overheads since most of the operations will be fully computerised and the organisational structure will be a trim one. They will also be free from the overhang of some of the restrictive regulatory practices of the past which have affected the functioning of the banks.

12. While the predominance of the public sector may come down, their role and significance will not. In fact in many ways, a role redefinition will have to take place for the public sector banks to continue to play an effective role. Presently,

the public sector banks have around 91 per cent of the total bank branches and handle 86 per cent of the total banking business in the country. Progressively, over the years, the public sector banks have expanded their branch network considerably and this is a great asset which their new competitors will find it difficult to achieve. The public sector banks thus will continue to play a major role. However, they will have to increasingly recognise that with greater competition and a new ethos in economic management, they will have to improve their levels of performance.

13. The special needs of the various sectors of the economy will continue to have to be taken care of by the financial institutions. Banks and term lending institutions are in fact, legitimate instruments of social and economic change. What is stressed is only that social responsibility must go hand in hand with the need to ensure the viability of the financial institutions. The productive sectors needs for their successful functioning an efficiently operation financial system which, while transferring funds from the surplus units to deficit units must do so at minimal operating costs. Cutting and containing costs, improving productivity and showing better profitability will have to be the objective and mission of all successful banks of tomorrow.

I wish the UTI Bank Ltd. all success in its endeavours.