Chapter 4

Causes of weakness

4.1 The Working Group has directly and, through the sub-groups constituted by it, gone into the causes of the three identified banks, viz., Indian Bank, UCO Bank and United Bank of India, becoming weak. These causes need to be addressed properly so that the remedial measures adopted prove effective and actually succeed in improving the functioning of these banks. The weakness identified by the Working Group relate to the following three main areas:

a. Operations

b. Human Resources

c. Management

These are discussed in detail in the following paragraphs.

Operations

Lack of a realistic strategic plan of action

4.2 Unrealistic assumptions have been behind plans and projections made in respect of critical aspects of the banks' operations such as reduction of NPAs, recovery, creation of fresh NPAs, generation of non-interest income, etc. Under most of these heads the performance of the banks has been wide off the projections made.

Share in business

4.3 In spite of their weak bank image, these banks are able to garner deposits obviously because of government ownership, deposit insurance and the public perception that government support would always be available. However, as may be seen from Annex 9, they are slipping in other key areas of their operations. Investments are replacing advances, particularly remunerative advances, and income from non-fund based business is not growing or is growing very marginally. The capability of these banks to do full range banking business in a manner that would result in a healthy bottom line is, therefore, being further impaired. It may be added in this context that with a much higher share in the number of branches these banks are not able to attract corresponding share in business even after providing for the fact that total share of income earned by public sector banks as a class did not correspond with their number of branches.

Limited product line and revenue stream

4.4 Another cause of weakness is the lack of any well thought out strategy to improve their product line. The existing products are also not being marketed effectively. As a result, these banks are operating almost entirely on a single revenue stream, namely, interest income. Here too, they are unable to meet the pricing offered by their competitors both in respect of liabilities as well as assets.

Over dependence on interest income alone is impacting their earning capacity very adversely in a falling interest rate scenario. The banks also do not possess the required capability to manage interest rate related risks which makes sustainable viability of their operations even more suspect.

High NPA and high fresh NPA generation

4.5 The position with regard to the level, recoveries and fresh generation of NPAs is given under Annex 10. All the three banks have built up a high level of NPAs over the years. Further, although UCO Bank was able to keep addition to NPAs lower than recoveries made in the years 1997-98 and 1998-99, in the other two banks, fresh generation of NPAs has been higher than recoveries. In UCO Bank also, the size of addition has still been quite large and, as a result, there has not been much improvement in the overall size of NPAs in the bank. This is mainly due to poor appraisal skills and non-upgradation thereof to keep up with the changes in the market environment and deregulation in various credit-related areas. Some of the credit decisions, especially in the case of Indian Bank, are allegedly cases of misfeasance. These are under investigation by various agencies including the judiciary. The high level of NPAs has affected their ability to recycle funds and has resulted in lower return on assets as also low net interest earnings.

Slow decision-making process resulting in loss of business

4.6 The problem of NPAs is compounded by the fact that decision making in respect of both sanction of fresh advances and disposal of proposals for recovery of bad loans through compromise has been very time consuming. This has greatly contributed to the slowdown in sanction of fresh credit although it is also partly due to a conscious decision to park funds in government securities rather than in advances. The banks have also been excluded from several consortia partly on account of the slow decision making process, overpricing, poor services and an overall poor image.

Slow growth and loss of fund-based advances leading to fall in income from non-fund based business

4.7 As a result of the negligible growth in advances, the banks' share in business has suffered. These banks have been growing at levels far below the industry growth rate. Consequently, income from fee-based activities such as remittances, forex business, guarantees and LCs, which is already at a low level in these banks, is diminishing further. The banks have failed to develop alternative non-interest, fee-based sources of earnings. Indifferent customer service, lack of skills, and unwillingness to innovate and customise products/services as per the customers'/market's expectations have been the main reasons for their failure to nurse their fee-based income. From some areas of remunerative business, e.g., forex transactions, these banks have been almost wiped out. United Bank of India, a bank with over 1,300 branches could earn from its forex transactions only Rs. 8 crore in the entire year 1998-99. The bank's earnings from this source have been virtually stagnant at the level over the past three years.

Absence of cost control

4.8 In the absence of avenues for growth in income, cost cutting measures assume significance in any effort to regain profitability. However, as may be seen from Annex 11, costs, particularly overhead costs, are very high and are proving to be uncontrollable. These have already exceeded or almost exceeded the entire revenue earnings (net interest income plus other income) in these banks. While the chances of the revenue earnings growing at a good pace are extremely limited, the overhead costs continue to grow relentlessly.

Absence of worthwhile MIS and costing exercise

4.9 What compounds the problem further is that the three identified banks do not have any worthwhile costing exercise, nor is there any MIS which can help such an exercise. Available information indicates that the margin between cost of funds and net average yield is extremely thin and may be difficult to sustain. Therefore, unless these banks are able to initiate drastic cost cutting measures, falling net interest margin and the resultant restrained growth in their net interest income can make their revival an even more distant hope.

Poor management of risks

4.10 At the back of most of the problems discussed above is the fact that the identified banks have not put in place any risk management mechanism. As a result, they are exposed to every conceivable credit and market risk. In the absence of adequate systems and skills to identify existing and potential credit risks, slippage in performing assets is very likely. Further, the increasing shift to investments in government securities resorted to by weak banks in the last few years for deployment of resources could expose the banks to interest and market risks and serious maturity mismatches.

Poor customer acquisition

4.11 Customer service in these banks is perceived to be as of poor quality. This is due to a weak administration and, as discussed below, lack of IT orientation in their operations. Partly because of this and the non-competitive rates offered by these banks, remunerative clients are severing or restricting relationship and new such clients are not coming. This is a vicious circle that these banks seem unable to break with their existing systems and work culture.

Lead bank and RRB responsibilities

4.12 All the three banks have lead bank responsibilities in various districts. Moreover, UCO Bank and United Bank of India have both sponsored 11 Regional Rural Banks (RRB) each while Indian Bank has sponsored four. The RRBs sponsored by UCO Bank and United Bank of India had accumulated losses of Rs. 263.30 crore and Rs. 437.77 crore respectively as at the end of March 1999. Apart from contribution to initial capital and pro rata contribution to subsequent financial assistance, the sponsor banks also provide refinance at concessional rates apart from providing their own staff as chairmen and other senior officials. Further, the sponsor banks also provide training facilities and incur costs in monitoring the activities of the RRBs. Though these are not accurately quantified, RRBs are definitely a burden on the sponsor banks' resources.

Locational disadvantages

4.13 Concentration of branches in the Eastern and North-eastern regions has been a factor inhibiting the growth of the United Bank of India and the UCO Bank. In the case of the former, such branches constituted 87 per cent of its branch network while, in the case of the latter, it was 43 per cent. Over concentration of a bank in any region makes it susceptible to the changes in the economic fortune of that region and demands a much greater degree of flexibility and adaptability in its operating strategies. The two banks have, unfortunately, not been able to show such adaptability in their strategies. In the case of these two banks, their predominant presence in the East and Northeast has, therefore, been disadvantageous to them.

Role of subsidiaries

4.14 Indian Bank has three subsidiaries in the areas of housing, mutual fund and merchant banking, namely, IndBank Housing Ltd., IndFund Management Ltd. and IndBank Merchant Banking Services Ltd. The total investment in the subsidiaries is about Rs. 121 crore. The bank is likely to incur further losses on account of the poor functioning of its subsidiaries. For instance, the bank will have to fund the mutual fund to the extent of Rs. 79.54 crore towards schemes where indicative returns have been committed by the fund. An amount of Rs. 42 crore invested by the housing subsidiary in the ICDs issued by the bank's borrowers is likely to devolve on the bank.

Inability to upgrade technology

4.15 Given the change in environment towards a market-driven competitive economy, technology plays a major role in improving customer service, retaining market share and ensuring profitability. The level of technology available in these banks is mainly confined to the installation of ALPMs, PCs, etc. In the case of United Bank of India, only around 10 per cent of the branches have any form of computerisation. Indian Bank is, however, comparatively better off in this regard. At a low level of technology support, these banks would steadily lose business to other public/private sector banks providing high quality and speedier customer service.

Lack of internal control resulting in poor housekeeping

4.16 As a result of the above factors such as lack of computerisation, poor MIS, frequent changes in management, etc., internal control and housekeeping have suffered. This has also acted as a deterrent to acquisition of new business at many of their branches.

Human resources

4.17 The details of staff strength for the three banks are given below:

Table 2: Break-up of total employees as on 31 March 1999

Name of the Bank	Officers	Clerical	Sub-staff	Total
Indian Bank	9,280	13,423	4,024	26,727
UCO Bank	8,437	16,739	6,910	32,086
United Bank of India	5,701	11,022	5,034	21,757

Source: Balance sheets.

Adverse age profile of staff

4.18 The average age profile in all the three banks is on the higher side. In the United Bank of India, the average age is above 45 years with most of the managers in the middle and junior management levels being above 50 years of age. In a fast changing environment where business practices are becoming more complex, new products are being introduced and advanced technology is becoming a way of life, the ability of the employees to adapt to this new environment and acquire skills to function effectively in that environment assumes great importance.

Low productivity

4.19 The Working Group has tried to make an assessment of productivity levels of banks. For this, “business per employee” is the yardstick presently used in the industry. Though this ratio has certain inherent deficiencies, the Group has gone by it for want of a more precise indicator. The relative position of the identified banks as well as other banks with regard to their business per employee is shown below category-wise.

Table 3: Business per employee (Rs. crore)

	1996-97	1997-98	1997-98	
			Highest	Lowest
Public sector banks	0.66	0.76	1.19	0.48
Old private banks	0.96	1.15	1.59	0.50
New private banks	5.54	6.64	17.45	3.58
Indian Bank	0.70	0.75	—	—
UCO Bank	0.42	0.48 —	—	
United Bank of India	0.57	0.65	—	—

Source: Bank returns

4.20 The three identified banks show lower than average industry level productivity of staff. Even in a few one to one comparisons of business and staff levels, the identified banks appear much worse off than others. For instance, for the year 1998-99, the business level of Allahabad Bank at Rs. 19,885 crore (average deposits plus advances) was higher than that of UCO Bank at Rs. 18,044 crore. The nature, spread and quality of business are more or less similar. However, UCO Bank has over 9,000 more staff than Allahabad Bank.

Excess staffing

4.21 The above position is indicative of the fact that staffing in some banks has been more liberal and that the present level of staff is more than what the type and size of business handled by these banks can justify. Such excess and quite often lopsided staffing is seriously affecting their cost of operations and, ultimately, the bottom line.

4.22 The restrictive practices in deployment of staff have further aggravated the cost of overstaffing. Consequently, latent business opportunities at advantageous urban/semi-urban/rural centres have remained untapped while over-manned establishments at metro centres continue to make operating losses.

4.23 An examination of the relationship between the total income earned by a bank and the staff cost it incurred for earning that income would provide a good measure for judging the payback from the staff cost incurred. It would also indicate clearly how well or ill placed the concerned bank is to bear that cost. A table showing the ratio of staff costs to total income (total interest plus non- interest income) for all public sector banks is given below.

Table 4: Ratio of staff costs to total income (1998-99)

Sr. No.	Name of the Bank	Percentage of staff costs to total income
1.	Oriental Bank of Commerce	10.59
2.	Corporation Bank	10.61
3.	State Bank of Travancore	14.79
4.	Bank of Baroda	15.65
5.	Union Bank of India	16.42
6.	Canara Bank	16.54
7.	State Bank of Patiala	16.56
8.	Dena Bank	16.74
9.	Punjab and Sind Bank	17.22
10.	Bank of India	17.89
11.	Allahabad Bank	18.07
12.	State Bank of India	18.52
13.	State Bank of Hyderabad	19.76
14.	Vijaya Bank	19.87
15.	Indian Overseas Bank	19.95
16.	Andhra Bank	19.98
17.	State Bank of Indore	20.40
18.	State Bank of Saurashtra	20.83
19.	Punjab National Bank	21.41
20.	**United Bank of India**	**22.26**
21.	Central Bank of India	22.89

22.	State Bank of Mysore	22.99
23.	**Indian Bank**	**23.40**
24.	State Bank of Bikaner & Jaipur	24.24
25.	Bank of Maharashtra	24.31
26.	Syndicate Bank	25.00
27.	**UCO Bank**	**25.74**
	Median @	19.14

@: Excluding Indian Bank, UCO Bank and United Bank of India.
Source: Bank returns.

As would be seen from the above table, in the three identified banks, staff cost as a proportion of total operating income has been above the industry median level.

Low skill levels

4.24 Yet another area of concern is the level of skill in all the three identified banks, which is rather low. Promotion policies have predominantly favoured seniority over merit. There is also no practice of lateral intake of specialised staff. This has led to low levels of motivation and skill. Skills in the areas of foreign exchange, treasury management and other specialised areas are not significant enough to generate business in these areas on a sustained basis. The emphasis on preventing incidence of NPAs has seen a reduction in or near absence of exercise of sanctioning powers at the lower levels. As a result, whatever skills for credit appraisal that were there are also getting eroded.

Lack of motivation

4.25 Prolonged slowdown in business, adverse comparison with stronger banks and high NPAs have affected the morale and motivation of employees at all levels. This and fear of accountability for bad loans have almost killed every initiative for doing fresh business. Because of the management's continued failure to provide strong leadership and direction, staff unions have arrogated to themselves many management decisions relating to transfer, placement and even promotions, giving rise to a large number of restrictive practices.

Training

4.26 The training facilities of the three identified banks are not adequate to meet the training requirements of their staff strength. As a result, the periodicity of training is only once in several years even for officers. There have also been instances of employees turning down training opportunities which may be attributed to the higher age profile, lack of motivation and infrequent transfers.

Management

Lack of succession planning

4.27 There has been virtually no succession planning in all the three banks inasmuch as senior functionaries are not groomed to take over responsibilities in the same bank at the top as an ED or CMD. As a result, the incumbents in the posts of General Managers and ED do not always identify themselves with the bank to the extent that they would have, had they been in the line of succession for the top most positions within the same organisation.

Short tenures and frequent changes in top management

4.28 Short tenures and frequent changes at ED/CMD levels have compounded the above problem. There have also been instances, especially in the case of UCO Bank, when top management posts have remained vacant for considerable lengths of time. In the case of Indian Bank, repeated extensions of tenure of three months each were given to the CMD. Short tenures and frequent changes lead to the adoption by the management of a tentative approach towards serious issues and lack of long term strategic planning.

Inadequate support from the Board of Directors

4.29 Guidance and support received by the three banks from their respective Board of Directors has been less than adequate. These Boards are not broad-based enough to include sufficient number of experts from areas related to banking, finance and management and have not always been able to provide the kind of support and guidance that is needed in a critical situation.

Lackadaisical implementation of earlier SRPs and MOUs

4.30 Restructuring efforts made so far have mostly been in the form of recapitalisation and have practically been unconditional. Though Strategic Revival Plans (SRP) were prepared and Memoranda of Understanding (MOU) with performance targets signed, measures to be taken in the event of the concerned banks' failure to fulfil the understanding or to meet the performance targets agreed upon were not thought of. The SRPs and MoUs, therefore, were never more than guidelines. The result is that, even after the infusion of Rs. 6,740 crore in the three banks over the last seven years, their basic weaknesses still persist.

Unfailing and unconditional recapitalisation

4.31 Management, the work force, as well as the unions have, therefore, tended to take things easy and no serious effort has been made to address the problem in the firm belief that government support will be forthcoming whenever needed. Unfailing and unconditional financial support by way of recapitalisation from the Government of India has actually proved to be a moral hazard.