Chapter 7

Restructuring strategy

7.1 Much of the discussion that will follow in this chapter will have emerged from the past international experiences as well as our own in restructuring weak banks, some of which have been recorded in Chapters 2 and 5 of this report. There are indeed no accepted best practices in this regard. However, there are some basics which apply everywhere and if not heeded will nullify any attempt at restructuring howsoever sincere and expensive it may be.

7.2 The first most important principle is that the restructuring exercise has to be comprehensive. It must address operational and financial restructuring simultaneously. In bank restructuring there is never any room for half way measures or gradualism. Any such exercise which does not encompass both operational and financial restructuring has in it seeds of failure and invariably fails. Our own experience in this regard so far has not been any different. It is very tempting to confine restructuring to financial aspects since solvency is immediately restored and there is a visible impact on the balance sheet. This no doubt appears to be the easiest, but hardly, if ever, would it lead to lasting removal of the ingrained weakness. If operational aspects crying for correction are not attended to long term sustainability of the bank cannot be ensured. This will only lead to additional problems necessitating further and costlier restructuring down the road.

7.3 There is always a tendency on the part of weak banks to overlook or hide their weaknesses. A hope that the position will be corrected soon is eternal and such thinking, self defeating as it is, almost invariably delays the really needed corrective action. In the meantime, the banks themselves, opting for incorrect and often riskier business strategies, try to show better short term results. In the process the cost of restructuring goes up and if delayed too much the possibility itself, of a successful restructuring, becomes remote. Unfortunately, our approach to bank restructuring so far has been somewhat akin to what has been described above and it is time that a far more comprehensive and decisive view of the issue is taken.

7.4 Future restructuring strategies for weak banks must incorporate the following core principles:

a. Manageable cost: The restructuring effort that is embarked upon has to be at the least cost possible. However, the fact that injudiciously chosen lower cost alternatives may lead to much higher costs in the long term must not be lost sight of.

b. Least possible burden on the public exchequer: As far as practicable the cost of restructuring must come out of the unit being restructured.

   Even if its contribution to the cost of restructuring is not available upfront, it should be possible to recover this later, out of the value that can be created by the restructuring. The need to minimise the burden of such cost, preferably initially, but certainly finally is obvious and cannot be overstated. Any plan for restructuring which does not clearly result in value addition at the end of the exercise, is not worth attempting.

c. All concerned must share losses: The restructuring strategy as also the instruments employed in the implementation of this strategy have to make a clear statement about the manner in which the losses already incurred and to be incurred have to be shared. The principle of sharing of losses will have to remain fully operative in both operational and financial restructuring envisaged for a bank. Such a plan for sharing losses will include

reduction in staff as well as all other administrative cost of operations.

d. Changes for strong internal governance: The internal governance of the bank and its operations at all levels have to be strengthened and fully sensitised to the needs of protecting against all foreseeable future problems. Restructuring always involves some amount of destabilisation in the organisation and during this period as also immediately after it, management and all its operatives have to make sure that the intended benefits of the restructuring plans are not allowed in any way to be frittered away or lost due to delays and lack of diligence in its implementation.

e. Effective monitoring and timely course corrections: Individual restructuring plans are to be implemented by the banks concerned internally and their success will depend upon the quality of governance and organisational commitment to the proposed restructuring. However, for a successful restructuring it is important that there is an independent agency which will own it and in the process of driving it forth, constantly monitor its progress. This role can be played by the owner but such an arrangement has limitations because of the conflict of interests that is likely to arise in such cases and the lack of time and skill for the job, which the owner may suffer from. It will be more so when the ownership of the banks is with the government. For obvious reasons, this responsibility cannot be given to the regulator either. The regulator will no doubt have interest in the success of the restructuring programme but direct efforts on its part to ensure its implementation could result in conflict of interests. The objective can, therefore, be best achieved by an independent agency, which with the express consent of the owner shall have full authority over the restructuring process and be in a position to effectively monitor its progress. In this process, while this independent agency will monitor to ensure that the restructuring process remains on course, wherever necessary it shall also take steps to facilitate due implementation of the plan. Such steps by this agency may include devising corrective measures and ensuring that the banks concerned adopt these measures.

f. Ease of implementation: Above all there must be an all-round consensus on the process of restructuring, its modalities and timing. The process itself and all the attendant instruments and instrumentalities will have to be simple and easy to employ.

7.5 While setting the core principles, which should govern any programme of bank restructuring, is not so difficult, deciding upon precise modalities of restructuring is, indeed, quite a vexatious and difficult issue to settle. As can be learnt from international experiences various modalities and quite a few variations of each of these modalities have been tried with varying degrees of success. In their time and given socio-economic environment each of these options chosen had good logic behind them. While, therefore, they have their applicability and merit these are certainly not transplantable where the prevailing conditions are different.

7.6 Mainly bank restructuring has been attempted using one of the undermentioned four modalities. Sometimes a combination of one or more thereof has also been tried. These are:

a. merger or closure,
b. change in ownership sometimes from private to government, but more often than not from government to private owners,
c. narrow banking,
d. comprehensive operational and financial restructuring of existing units.

7.7 In the following paragraphs, the applicability of each of the above options in the present Indian context, has been examined with a view to selecting the one which at this point of time is most suited to the socio-economic conditions prevailing and, therefore, has the best chance to succeed.

Merger or closure

7.8 Merger between two banks and for that matter any two entities would be of any advantage only if it takes into account the synergies and complementarities of the merging units and provides opportunities for pooling of strengths. The overall reduction in cost of operations of the merged entity ensures improved operational efficiency and greatly enhances its competitive abilities. Mergers and acquisitions, world over, have, therefore, been primarily volume driven and often in response to the competition or environmental necessities. Often the objectives of merger are consolidation, better positioning and larger market share. In this quest, rationalisation of business lines, staff strength and the administrative structure are common and sacrifices in the merging units are unavoidable. The socio-economic environment in India does not, however, permit such changes to be made easily.

7.9 The problem gets compounded if, of the two units merging, one is already suffering from serious operational deficiencies and is merging with another comparatively larger unit merely to save its existence albeit in a modified form. In such a situation, while the weak unit merges its deficiencies in the stronger unit, the merged entity does not get any opportunity to avail of post-merger advantages. As a result, the merged unit itself becomes weak and often loses its competitive abilities.

7.10 The experience of bank mergers in the public sector has so far been limited to that of New Bank of India with the comparatively strong Punjab National Bank in 1993. The result of this merger was no different from the worst apprehensions expressed above. A direct result of the merger was that Punjab National Bank, a strong bank with uninterrupted record of profits, had to record a net loss in 1996 of Rs. 95.90 crore. The bank also had to face litigation and other problems especially relating to service conditions of the personnel taken over some of which are still persisting. The merger clearly demonstrated the futility of merging banks with different work cultures, ethic and skill levels of the employees whereby even the stronger bank was put to severe stress. Till today little evidence is available of any worthwhile advantage having accrued to Punjab National Bank from the merger.

7.11 The Working Group is, therefore, of the view that mergers even between two strong banks would serve any purpose only if it can be quickly followed by advantageous restructuring resulting in sizeable cost reduction and a markedly higher share in business and profits. Merger between two weak banks would serve no purpose whatsoever and if at all a plan of giving the two entities a wider geographical or business spread is to be worked out, the concerned banks' working will have to be first brought to a minimum level of competitive efficiency. It would then be possible for the merged entity to have a fighting chance of survival and not sink under the weight of its own heightened inefficiency. Given the present scenario, merger of a weak bank with another weak bank or with any other stronger bank would be totally counterproductive. The Working Group, therefore, does not recommend merger as a possible Solution for reviving the weak banks without first restructuring them.

7.12 Closure has a number of negative externalities affecting depositors, Borrowers, other clients, employees and, in general, the areas served by the banks being closed. Besides the misery that it will bring to the depositors, a large number of the borrowing clients of banks

under closure also could run into Difficulties and their businesses may suffer causing substantial economic loss. The overall cost of closure, therefore, is always high. This is an extreme option and would need to be exercised only after all other options of successful restructuring have been ruled out.

Change in ownership

7.13 International experience shows that diluting or completely removing government ownership of financial institutions is one of the commonly used strategies in bank restructuring. Such transfer of ownership may be to existing reputed corporate groups or to foreign banks or others.

7.14 The Working Group considered the option of privatisation in the context of restructuring weak banks and feels that privatisation is a desirable objective in the long run. It would have the following benefits:

a. The government will be able to recoup, wholly or partly, the cost incurred by it for restructuring these and other banks. As a result,the ultimate burden on the fiscal budget is reduced considerably.
b. The moral hazard contained in the implicit assurance that government support will always be available is removed.
c. Limitations in adopting a unit-specific policy with regard to recruitment, compensation, technology, deployment of resources, etc. are removed.
d. The performance of the privatised units becomes more market- driven and, as a result, its management shows greater accountability in meeting the expectations of its different stakeholders.

7.15 The Working Group is of the view that privatisation is a good option for restructuring weak banks in the Indian context as well. However, privatisation of weak banks at this stage is unlikely to be successful for the following reasons:

a. The cost of restructuring weak banks is prohibitive and no private group can normally be expected to bring in the kind of resources that are required.
b. The banks are not likely to access the capital market successfully given their present financial state.
c. The present staffing pattern, the level of available skills and lack of technological sophistication are likely to act as deterrents to any private or foreign investors.

Restructuring through privatisation can, therefore, be undertaken only after the above issues have been sorted out. Without attending to these, even if a privatisation plan succeeds, it is likely to prove very expensive. With the banks in their current shape, the government may not be able to recover much value for the very sizeable amount of capital it has invested.

Narrow Banking

7.16 Narrow banking, as an option for restructuring weak banks in India, has been a subject of serious debate and discussion for some time. The suggestion was first made by the Committee on Capital Account Convertibility, which proposed that "the incremental resources of these narrow banks should be restricted only to investments in government securities and in extreme cases of weaknesses, not only should such banks not be allowed to increase their advances but there would need to be a severe restraint on their liability

growth”.[10]

7.17 In a slight variation, narrow banking has also been described as a situation where “a bank which is weak should taper down its incremental credit- deposit ratio – the weaker the bank, the lower the incremental credit deposit ratio”.[11] This definition gives a little extra room for credit but all the same is

restrictive. It may be noted in this context that all the three weak banks have pursued some form of narrow banking, as defined above, for reasons such as inability to lend to quality customers, as a matter of deliberate policy, high levels of NPAs and what has been termed as “fear psychosis”.

7.18 The practice of preferring government securities to fresh lendings has led to several cases of dissatisfied borrowers who were denied credit. Such dissatisfied borrowers, without fail, look for alternatives and finally, as soon as they are able to develop a new banking connection, change their bank.

7.19 Banks’ ability to generate non-interest income is closely linked to the size and quality of their advances portfolio. A restriction on this portfolio invariably results in fall in fee income. Such a two-pronged loss in income adds to the weakness of the bank making its recovery even more difficult. In the case of the weak banks, slowdown in advances has already affected growth of their fee income. This will make their recovery even more difficult.

7.20 In the Working Group’s view, the argument for pursuing a policy of narrow banking does not take into account the fact that government securities are also subject to market risks and that banks have to make necessary provisions for such risks. Dependence on a single stream of income by way of interest on government securities also exposes them to serious interest rate risks. Further, narrow banking entails a somewhat inefficient use of available resources.

7.21 It is well known that in a banking organisation, credit culture cannot be introduced or discontinued at will. A break in this culture during a period of credit refusals can do untold damage to institutions where, unlike those abroad, personnel at various levels of employment cannot be moved in and out depending upon changes in the business strategy.

7.22 The entire rationale for narrow banking rests on the premise that the weak banks do not have an efficient credit management team and that further advances made by them are most likely to end up as NPAs. While there are indeed gaps in skills, the Working Group feels that these need to be addressed separately and not by curbing growth in advances. In any case, narrow banking can, at best, be only a temporary phase and cannot by itself be adopted as a restructuring strategy.

Comprehensive operational and financial restructuring

7.23 With the three other options not being found suitable to the present environment, the only alternative left for consideration is that of comprehensive operational and financial restructuring. Therefore, the Group has tried to answer the question whether the option of restructuring is available in the case of the three identified weak banks.

7.24 The three banks are obviously beset with serious weaknesses. They have lost their competitive ability and are very seriously handicapped. Although through the entire ’90s,

each one of them has been recapitalised almost every year, with a total sum of Rs. 6,740 crore, they have still not been able to turn around and continue to depend on further capitalisation by the government. Indian Bank alone will need about another Rs. 1,000 crore urgently to gain the minimum prescribed capital adequacy of nine per cent with no guarantee that, at the end of the current year, once again they will not need further infusion of capital to maintain this ratio. The position of the other two is only marginally better as they do not need capital infusion immediately. However, their future operations too are unlikely to continue without further infusion of capital. It does not, therefore, make economic sense to let them continue in the present manner for, after all, the government cannot undertake to capitalise them endlessly.

7.25 A time has, therefore, come to take a long term view and to ensure that the present state of affairs does not get prolonged. The choice, therefore, is limited to either closing them or subjecting them to such extensive operational, organisational and financial restructuring as will completely change their cost structure and mode of operations and turn them into banks with minimum competitive efficiency capable of continuing their operations without any further external help.

7.26 As stated earlier, the Group is of the view that closure of banks, especially those with very extensive networks and large client base, as is the case with each of the three banks under consideration, must always be the last option. In the opinion of the Working Group, therefore, the choice of comprehensive restructuring deserves careful consideration. Any such restructuring, however, will mean exercising hard options and involve firm, decisive and timely actions.

For this, there has to be a clear commitment from the owner, the government. It must display firm political will and generate an all-round consensus that the restructuring will go ahead without let or hindrance. The management of the banks and the employee unions will have to come to an agreement before the restructuring exercise begins as regards every important ingredient of the proposed exercise. The crux of the issue is that it is going to be an expensive one-time exercise and, unless its success is reasonably assured, it will not be worth undertaking.

7.27 It is, however, to be recognised that options of merger and/or privatisation as time tested remedies are not to be ruled out *per se* as restructuring options unavailable to weak banks. The Group is fully conscious that these strategies would become increasingly relevant in the years to come when further deregulation and competition would inevitably point to the need for consolidation for survival. In the interim, however, restructuring of the weak banks would necessarily have to be a comprehensive but largely internal exercise.

7.28 The Group has developed for the three banks a four-dimensional comprehensive restructuring programme covering operational, organisational, financial and systemic restructuring. These are as under:

1. Operational restructuring involving

(i) basic changes in the mode of operations resulting in diversification of sources of income and increase therein,

(ii) adoption of modern technology,

(iii) resolution of the problem of high non-performing assets and the resultant loss of income, and

(iv) drastic reduction in cost of operations.

2. Organisational restructuring aimed at improved governance of the banks and enhancement in management involvement and efficiency.

3. Financial restructuring with conditional recapitalisation.

4. Systemic restructuring providing for, *inter alia,* legal changes and institution building for supporting the restructuring process.

In the opinion of the Group, subject to its receiving the kind of acceptability and support envisaged in paragraph 7.26 above, the restructuring could restore the three banks to health and efficiency.

7.29 The Group is of the view that the restructuring of the weak banks could well be a two-stage operation. In stage one, focus will be on operational, organisational and financial restructuring of the units involved aimed at restoring their competitive efficiency. In stage two of restructuring, the options of privatisation or mergers will assume relevance. The banks would have, by then, turned into "self-supporting banks" and could command, on their own, investor attention as good investment options.

7.30 In the three banks, which have already been identified as weak, viz., Indian Bank, UCO Bank and United Bank of India, structural as well as operational weaknesses have been most persistent and pronounced. As detailed in Chapter 5, various efforts were made in the past to study and find solutions to their problems. These studies provide a ready insight into the problems as also the nature of solutions offered and the reasons for which these solutions have so far either failed or succeeded only partially. In view of this and due to the limited time and resources available the Group could realistically focus its attention only on the three banks for the purpose of suggesting specific measures of restructuring.

7.31 The Group hopes that the broad pattern of strategies proposed on the basis of its approach as detailed in the following paragraphs for restructuring the three banks and the experience that would be gained in these exercises would facilitate evolution of a restructuring strategy for other banks as well which show signs of distress.

Operational Restructuring

7.32 Going by the international experience, Garcia[12] has identified the following as the key elements of operational restructuring of banks:

a. Formulating a business plan that focuses on core products and competencies.

b. Reducing operating costs by cutting staff and eliminating branches where appropriate, ceasing unprofitable activities, and disposing of unproductive assets.

c. Implementing new technology and improving systems of accounting, asset valuation, and internal controls and audit.

d. Establishing and enforcing internal procedures for risk pricing, credit assessment and approval, monitoring the condition of borrowers, ensuring payment of interest and principal, and active loan recovery.

e. Creating internal incentive structures to align the interests of directors, managers, and staff with those of the owners.

The Working Group considers the above to be a very good and concise statement of operational restructuring requirements. The plan evolved by the Working Group for restructuring of the three banks is also on similar lines.

7.33 The approach adopted by the Working Group in suggesting operational restructuring plan for the weak banks is two pronged: one of increasing income and the other of reducing costs. The objective of increasing income in its turn has to be achieved on the one hand by revamping the bank's mode of doing business and on the other by making suitable arrangements to reduce to the minimum the effect of current and future NPAs on their earnings. Cost reduction will have to be achieved by dropping the lines of business and products which are proving a drag on their profitability and also by putting every significant cost item including staff cost under the strictest scrutiny with a view to reducing it without, of course, affecting the required level of efficiency. For this purpose, it would be necessary to set benchmarks for achievements. These would be available by looking at the benchmarks set by peers and competitors. A serious and continued deviation from these benchmarks would only mean that the three banks will not be competitive and, in the end, lose out in the race totally.

Revamping the mode of doing business

7.34 In the situation the weak banks find themselves, the first thing that they need to do is to retain their business and client base and protect themselves against the possibility of being swiftly and completely overtaken by the competition. The most prominent shortcoming of the weak banks is the quality of their service and its limited range. The banking products offered by them are outdated and are being used mostly by that segment of clientele the relationship with which is least remunerative. Both on the asset and liabilities sides of their balance sheet, there is practically no product innovation and high cost of their operations is precluding them from pricing any of their products attractively.

7.35 In the interest of their survival, the three banks cannot afford to lose any further share in the overall business and require to develop urgently capabilities to launch new products, attract new customers and bring about an overall improvement in housekeeping, MIS and risk management.

Developing a special business focus

7.36 The Working Group found that all the three banks were trying to do everything everywhere without developing any special skills or strengths in chosen areas. None of them is identified with any special business or customer niche in which it has in the past been especially successful or could be so in future. Such business strategy as they may have lacks focus and, therefore, produces little results. Each of them, therefore, needs to develop strengths in chosen areas and build its skills and business strategy around those strengths. All

these three banks, particularly, United Bank of India and Indian Bank, have concentration of branches in a few states but, instead of devising strategies of making the most of that particular market, are insisting on assuming the character of large all-India banks. In the bargain, they are having the worst of both the worlds for they are neither any more dominant in the area of concentration nor are they able to make a mark countrywide.

Diversification of sources of income

7.37 As has been mentioned earlier, in some ways, all these three banks have been operating in the recent past as narrow banks relying more and more on investments in government securities as avenues for deployment of their funds. The growth of their credit portfolios has been extremely limited and fee-based earnings have been minimal. They need to take urgent steps to reintroduce credit culture and ensure a rapid growth in non-fund based earnings. The large network of branches which the three banks have can be leveraged well to increase fee-based earnings by merely laying stress on a few selected services, particularly, movement and management of funds.

7.38 It is obviously not possible for any bank to avoid credit business for long. Their selection of credit business in the few years preceding their becoming weak proved to be adverse largely because they left the traditional areas of business in which they had experience and moved into areas for which they neither had built skills nor had any past experience. They must, therefore, now select areas of credit in which they have had experience and those relating to which it is possible for them to develop expertise within a short time. The appropriate markets for them will be the middle and lower segments of the credit market. They need to concentrate more on the retail end of the business rather than large scale which has been their undoing.

7.39 As a means of increasing their income, management and unions of the three banks have put forward a plea for allocation of a share of business related to good PSUs and other government departments to them. They have argued that most such business goes to larger banks and that they are deprived of what they consider a rightful share. In the opinion of the Working Group, such an approach is neither practical nor desirable. The banks need to learn to withstand competition. In a deregulated environment, to take a step as suggested by them would be retrograde and going by the overall results counterproductive for the system. At the present stage of financial sector reforms, an arrangement for transferring good clientele by giving directives can be seen only as a step towards reversal of reforms. Moreover, the companies/corporations whose business is sought to be so transferred are themselves autonomous bodies and would assess their benefits before transferring their business from their present bankers to another. Banks which are at present not able to meet the clients' expectations of quality and cost on competitive grounds can hardly expect to get any new business by an administrative fiat. The Working Group, therefore, feels strongly that acquisition of competitive efficiencies is the only way for the banks to broaden their business base and to attract to their books blue chip PSUs or other remunerative clients.

Unprofitable operations which need to be shed

7.40 Two of the three weak banks have operations which are clearly not profitable and may prove to be a big burden on their future operations. These are their operations abroad and operations through subsidiaries. While UCO Bank and Indian Bank have their branches abroad, the latter has three subsidiaries for merchant banking, housing finance and managing mutual funds. The two banks need to pull out of these two areas without any further loss of time.

7.41 While it has been commonly argued that these operations are profitable and that even if there are temporary hiccups they remain profitable without affecting the banks' balance sheet adversely, this is actually not borne out by facts. Such arguments have limited validity viewed in the context that operating environments abroad are far more volatile and the quality of asset books of most Indian banks is not above average and is open to far greater risks than any comparable operation in India. The table below shows the operating results of foreign branches of UCO Bank and Indian Bank together with the position in regard to their NPAs.

Table 11: Performance of foreign branches (Amt. in Rs. crore)

Name of the Bank/branch	Net Profit/Loss		Profit remitted to India		Gross NPAs		Remittances from HO to branch	
	97-98	98-99	97-98	98-99	97-98	98-99	97-98	98-99
Indian Bank								
a. Singapore	(-)0.13	2.16	—	—	332.73	517.26	—	—
b. Colombo (FCBU)	0.10	0.22	—	—	62.40	68.29	—	25.27
c. Colombo (DU)	0.50	0.82	—	—	3.96	3.34	—	—
UCO Bank								
a. Singapore								Centre
i. Singapore Main	19.60	14.47	—	—	36.22	39.90	—	—
ii. Serangoon Rd.	(-)0.21	0.42	—	—	4.38	10.30	—	—
b. Hongkong								Centre
i. Hongkong Main	4.73	5.26	—	—	29.64	46.83	—	—
ii. Kowloon	4.55	2.46	—	—	13.49	21.79	—	—
c. UK Centre @	0.44	(-) 20.62	—	—	136.25	48.90	—	43.71

Note: @ London branch since closed.

It would be clear from the above that both UCO Bank and Indian Bank would find it extremely difficult to run these branches in the short and medium term. The position even now is tenuous and would get exacerbated if any of these operations runs into the slightest of difficulty. Even if they do not, the local regulators going by the present condition of the two banks could stipulate serious conditions regarding capital adequacy or administration of these branches which the banks are not likely to be able to meet. A sudden emergence of such a situation could pose a problem for not only the two banks but also for the Indian banking system. In 1998-99, Indian Bank had to remit Rs. 25.27 crore to Colombo to support its operations. UCO Bank too had to remit Rs. 43.71 crore to London where its branch was closed.

7.42 Since the foreign operations of the two banks have, at best, only marginal profitability, the Working Group is of the opinion that they need to be taken off the hands of the two banks notwithstanding any reservation that they may have on this score. These could be sold to prospective buyers including other Indian public sector banks subject to the necessary approvals. The resources raised could fund some of the various demands of the

restructuring operations.

7.43 Indian Bank has three subsidiaries, *viz.*, Indbank Merchant Banking Services Ltd. (IBMBS), IndBank Housing Ltd. (IBHL) and IndFund Management Ltd. (IFML). Of these, the first two subsidiaries are owned partly by Indian Bank and the third is fully owned. The IBMBS generated a meagre profit of Rs. 1.23 crore in 1996-97 and Rs. 1.20 crore in 1997-98 while the other two subsidiaries have been facing financial problems in the last two years. The inability of IFML to meet returns assured in one mutual fund scheme had to be made good to the extent of Rs. 43 crore by the parent bank as per SEBI directive. Likely losses on another assured return scheme, requiring to be foreclosed, would also devolve on the bank soon. Indian Bank was required to contribute Rs. 13.40 crore to IBHL during the year 1998-99 to enhance its capital adequacy ratio to eight per cent as prescribed by the National Housing Bank. Besides, the housing subsidiary has also suffered deterioration in its assets portfolio on account of investment in certain Inter Corporate Deposits placed with the borrowers of the parent bank which have since turned bad. The cumulative burden on account of the above developments will have to be passed on to the owners, i.e., the Government of India, since the bank itself is totally dependent on further infusion of capital by the government.

7.44 The Working Group is of the view that the subsidiaries of Indian Bank are likely to be a continued drag on its own viability and would add to the cost of restructuring. A decision to pull out of these needs to be taken by the bank at the earliest as part of the restructuring. The bank needs to concentrate on its core activities and redesign its business line in a manner that will reduce the need for further capital. An effort could also be made to find buyers for the bank's holdings in the subsidiaries care, however, being taken that the issue is not allowed to prolong.

Adoption of modern technology

7.45 Any meaningful revamp of the mode of doing business in public sector banks is not possible unless they are in a position to adopt modern banking technology urgently. Some efforts have been made in the three weak banks as well but these are insignificant viewed in the context of what competition is doing.

7.46 New private sector banks and foreign banks are now in a position to offer highly sophisticated and technology oriented products and services to their customers. Some leading public sector banks too have changed their technology substantially and achieved noticeable success in offering at least some of the modern banking products. Such products and use of technology not only make a bank customer friendly but also increase its capacity to handle much larger volume of business efficiently and thereby reduce service charges.

7.47 The rate of growth of business of banks using modern technology has so far been extremely fast and is likely to gain further momentum as the use of banking technology spreads out of metropolitan cities into smaller towns. The new private sector and foreign banks which have in the past four to five years gained over eight per cent each of the entire banking business available are now likely to increase their share at a faster pace. This will be at the cost of the older and larger banks and the weaker ones amongst them will be the biggest sufferers. There is little indication that, on their own, they will be able to adopt modern technology in the near future which implies that, in the next few years, their inability to attract new clients and retain the existing remunerative ones will make their position even more untenable. Urgent steps have to be, therefore, taken to alter this position.

7.48 In the Working Group's view, a technology initiative has to be necessarily the starting point for the restructuring process. Unfortunately, however, the three weak banks just do not have the physical, financial and human resources to define, design, implement, manage and maintain complex IT solutions of the kind that are required to meet the challenges posed by new players as well as the more efficient of the existing players in the market. It is this limitation which has so far caused a lukewarm attitude towards modern technology in the three banks. For them, therefore, a special solution needs to be found on an urgent basis.

7.49 Both because of the limitations of staff and skills mentioned above and the high costs involved in building up separate infrastructure for the three banks, the Working Group is of the view that a desirable solution for these three banks would be to have common networking and processing facilities. Alternatively, the three banks, depending on geographical factors could consider tying up with other banks, which have not been as yet identified as weak, for greater strategic advantage. Such sharing is beneficial because it leads to lower costs and greater efficiency of operations. State-of-the-art technology can be obtained at affordable prices. It would enable the three banks to bring into their operations, at an earlier date than would otherwise be possible, modern banking products like 'anywhere banking' and 'anytime banking', telebanking, electronic data interchange (EDI) and internet banking.

7.50 In the situation that the weak banks find themselves, it would be best for them that such common facilities be outsourced from an existing reputed company, which will run the system for them. The main benefit of such outsourcing will be that it will enable the three banks to get over the problem of an almost total lack of skills in these areas. Besides, such outsourcing will enable them to get the facilities upgraded whenever needed in a far more timely and cost-efficient manner than if they were to manage their respective facilities on their own. Under this arrangement, while the banks would own the hardware and the software licensed to them, managing of the system would be done by the outside agency. The service provider could also be invited to follow a 'Build Own Operate Transfer' model for this purpose. This agency, as a facilitator, would provide the common communications infrastructure for networking, etc., and be expected to do the following:

a. identify the IT requirements of the participating banks,
b. design total IT solutions that meet the above requirements,
c. implement the solution in consultation with the participating banks,
d. actively participate in the procurement and installation of all necessary hardware and other equipment,
e. manage and maintain the systems,
f. adapt IT to changing technology and business needs,
g. evolve new technology-based products,
h. train all staff identified to function in the new environment.

7.51 Implementation of an IT solution in the aforesaid manner is expected to yield the following benefits:

a. facilitate bank-wide risk management, asset-liability management and profitability analysis,

b. help integrate the domestic and forex treasuries with the rest of the bank,

c. provide a common IT-related management talent,

d. provide access to technical skills,

e. enable introduction of extended working hours and shifts,

f. improve overall customer service in the banks.

7.52 Gearing up an entire bank to work in an IT-driven environment will take time. Therefore, this process has to necessarily go through different stages. The Working Group feels that in the first stage of implementation itself, which may be spread over twelve to eighteen months, the IT solutions should target coverage of over 70 per cent of the participating banks' present business. This would require that around 250 to 300 of the largest branches from each of the three banks be linked to the proposed outsourcing of technology requirements.

7.53 The Working Group obtained the views of Infosys Technologies Ltd. (ITL), which has considerable experience in providing IT solutions to Indian banks, to arrive at a realistic estimate of the level of investment that would be required to implement the above strategy. Taking into view the estimates provided by ITL and also the extent of technology induction that would be required, the Working Group has estimated the total cost at around Rs. 300 crore. This will cover the cost of implementing the solution at 300 branches each from the three banks and the cost of central hubs and about 600 ATM switch and telebanking points. It excludes the cost of PCs, which may already be available to a large extent, cost of training and other recurring costs. In order to cut costs, while actually implementing the IT solution, the banks may consider the feasibility of utilising the excess capacity available with the already existing networks.

7.54 Obviously, the three banks will not be in a position to bear the cost of implementing the above recommendation and would, therefore, require government assistance in this regard. Such assistance may come in the form of further capitalisation for the three banks specifically earmarked for this purpose. Elsewhere in this chapter, the Group has made recommendations about the aggregate additional recapitalisation required for the three banks. In that context, it has already been suggested that further capitalisation may have to be earmarked for specific purposes. This recommendation is in line with the proposal.

7.55 It may also be added that assistance for modernisation initiatives is also available from multilateral agencies. The Group had an occasion to discuss this issue with the representatives of World Bank when they were visiting India in connection with the monitoring of one of the loans sanctioned by them of which Indian Bank is one of the beneficiaries. The impression gathered by the Group from the discussion was that World Bank assistance for this purpose may be feasible. This source of funding would also be worth exploring.

Reduction of NPAs

7.56 NPAs have been the single most vexing problem faced by the public sector banks. Banks that have been identified as weak are mainly so because of the loss of their income, high carrying costs of NPAs both in terms of their funding as well as provisioning and the general stagnation of operations caused by the NPAs in their books. The position of NPAs in Indian Bank, UCO Bank and United Bank of India and their movement during the three years 1996-97 to 1998-99 is furnished in Table 12. It may be seen from the table that the aggregate NPAs of Indian Bank and United Bank of India have been rising in the last three years while

that of UCO Bank showed marginal decline during the period. Noticeably, additions to NPAs in the Indian Bank outstripped recoveries in all the three years.

Table 12: Movement in level of NPAs (Rs. crore)

	Gross NPAs at beginning of the year	Recoveries made during the year	Addition to NPAs during the year	Closing balance
Indian Bank				
1996-97	3,140 (34.15)	482	645	3,303 (39.12)
1997-98	3,303 (39.12)	347	472	3,428 (38.96)
1998-99	3,428 (38.96)	164	445	3,709 (38.70)
UCO Bank				
1996-97	1,840 (24.54)	354	387	1,873 (28.35)
1997-98	1,873 (28.35)	371	278	1,780 (24.04)
1998-99	1,780 (24.04)	327	263	1,716 (22.55)
United Bank of India				
1996-97	1,401 (38.00)	167	164	1,398 (36.20)
1997-98	1,398 (36.20)	97	150	1,451 (33.50)
1998-99	1,451 (33.50)	101	199	1,549 (32.39)

Note: Figures in brackets indicate percentage of Gross NPAs to Gross Advances.

7.57 A sizeable portion of the aggregate NPA with the public sector banks is that of chronic NPAs, i.e., loans which have remained as non-performing in their books for several years in some cases running into decades. Besides, a significant portion of the NPAs is locked in legal proceedings or in the BIFR and cannot be expected to be recovered in the foreseeable future. There are also loans given to state or central public sector units which they have failed to repay. These loans are both with or without government guarantees. The banks have found it difficult to proceed against these units and recover their dues even where there are government guarantees. The table below gives the details of such chronic NPAs of the three weak banks as on 31 March 1999.

Table 13: Details of chronic NPAs as on 31 March 1999 (Rs. crore)

	Indian Bank	UCO Bank	United Bank of India
a. BIFR	465.49	200.08	238.95
b. Suit filed cases @			
i. With DRT	2,767.04	573.68	272.00
ii. With courts	44.00	213.79	365.00
c. Dues from PSUs			
i. With government	0.85	91.90	58.64

	guarantee			
ii.	Without government guarantee	12.13	—	6.98

@ includes cases decreed but not executed.

7.58 Chronic NPAs are likely to prove a big handicap in the revival of weak banks and it is therefore necessary that measures are found to ensure their resolution at an early date. As is known, while setting up of BIFR has helped in some ways, in some other its operations have proved disadvantageous to banks in recovery of their dues. Cases in which borrowers have engineered to take the shelter of BIFR to avoid recovery proceedings are not uncommon. Also, BIFR proceedings, for various reasons, do take a long time during which while all recovery proceedings against a borrowing unit come to a standstill, it retains control of all its assets and continues to deal with them freely. This often leads to weakening and/or loss of the banks' securities/ collaterals for the advance and reduces chances of recovery. While amendments to the Sick Industrial Companies Act, 1985, are being considered to take care of some of the concerns mentioned above, these have been a long time in coming.

7.59 Although the setting up of Debt Recovery Tribunals had raised much hopes about speeding up of the recovery proceedings initiated by banks these hopes have largely remained unfulfilled. At quite a few places, the DRTs are still to be set up and, even where these have been set up, they are not yet fully equipped to handle very large number of cases already before them or those that can be placed before them. In some of the DRTs, the number of pending cases is now quite large. While the government has been reviewing the operations of DRTs, as yet a stage has not come when it can be said that these are helping recoveries of banks' dues substantially.

7.60 The dues with public sector units pose their own problems of recovery. While in recent years there has been some change in the attitude, the response of the borrowing units to the banks' efforts towards recovery of their dues has largely been negative presumably because of their government ownership. The situation has not been much different even where these loans are guaranteed by the state or the central government. The Group is of the view that where guarantees have been given by the central or state governments and a demand thereunder has been raised by the banks, these demands need to be met. It may be mentioned in this context that with effect from the year beginning 1 April 2000, banks will be required to make provisions against non-performing loans even if these bear state government guarantees.

7.61 In recent years, public sector banks have resorted to compromises as one of the means of reducing NPAs on their books. While some progress has been achieved through this route, it has actually been limited. This has largely been due to the apprehensions on the part of the banks about the terms of compromise being challenged. These apprehensions have grown in intensity as quite often there have been allegations from different quarters about the compromises not being fair or undue favour having been shown to the borrower. Fears of such allegations and subsequent intervention by investigating agencies has been a big block in the way of compromises being arrived at in some banks. In weak banks, where the NPAs are high and the level of confidence is low, compromises are more often than not, being avoided. An effort was made in some banks to get over these hesitations by setting up Settlement Advisory Committees (SAC) headed by an independent retired high court judge and aided by a senior retired bank official to help arriving at compromises. It was hoped that

compromise figures/terms arrived at with the help of SACs will not be open to many questions and the banks will be able to go ahead with the compromises with greater confidence. This has not always happened as the banks have not had the confidence to go ahead with the compromises especially in the case of larger loans.

7.62 It is necessary that this otherwise effective measure be used to greater effect by the weak banks in reducing their NPAs. In the light of the experience gained so far, it would be desirable for the Boards of the three banks to lay down clearly their expectations in most cases of compromise. As long as the recommendations of the SAC match these outlines, there should be no case for delaying compromises it recommends on the general ground that these could be improved. A greater reliance must be placed upon the recommendations of the SACs in order to make a better use of compromises for reduction of NPAs in the bank's books.

Separating NPAs from weak banks

7.63 The quickest and possibly the most effective way of removing NPAs from the books of the weak banks would be to move these out to a separate agency which will buy these loans from the banks and make its own efforts for their recovery. Separate institutional arrangements for taking over problem loans have played a key part in bank restructuring in different countries with varying degrees of success. To name a few, these include the Resolution Trust Corporation in the USA, Securum and Retriva in Sweden, the Cooperative Credit Purchase Company, the Resolution and Collection Bank and the Housing Loan Administration Corporation in Japan, and the Korea Asset Management Corporation in Korea. There has been no uniformity in either the structure or mode of operations of these companies. These differed according to whether these were government owned or privately owned and whether these were set up for one bank, a group/class of banks or for the whole system. Some were given a fixed time limit for completing their operations while certain others have been set up to function on an ongoing basis. Their relative successes, however, depended on the extent to which their operations were structured to suit the local conditions.

7.64 The Committee on Financial System (1991) had suggested setting up of an Asset Reconstruction Fund and, as an alternative thereto, the CBSR (1998) recommended transfer of these assets to an Asset Reconstruction Company. A special Group was also set up by the Government of India in July 1998 for suggesting an operating plan for setting up Asset Reconstruction Companies. The present Working Group too has seen separation of NPAs as an important element in a comprehensive restructuring strategy for weak banks and considers this mechanism to be an acceptable solution to the problem of accumulated NPAs and the resultant strain on profitability of banks.

7.65 Selection of a proper financial vehicle through which non-performing loans can be transferred out of the weak banks' books is the key issue. After due consideration, the Working Group has come to the conclusion that in our situation it would be desirable to develop a structure which will combine the advantages of government ownership and private enterprise. The broad structure would be that of a government-owned Asset Reconstruction Fund (ARF) managed by an independent private sector Asset Management Company (AMC). The key elements of this structure and its operational details are discussed below.

<u>A two-tier ownership management structure</u>

7.66 Assets belonging to public sector banks can be transferred with least complications to

a public sector body/agency. Considering the size of the capital that will be needed for this exercise, the problems relating to pricing of the assets to be transferred, the desirability of making these transfers unchallengeable by the borrower or anyone else and the urgent need for changes in the available legal framework so that early enforcement of the lender's rights becomes possible, it would be best if the ownership of the transferred assets lies with the government. However, the government body owning the assets may not possess the necessary skills and attitude to ensure their recovery and it may suffer from the limitations which most public sector units suffer. It is, therefore, proposed to have a two-tier ownership management structure in which the ownership of the assets will lie with the government and the management thereof with a separate private sector entity having the necessary expertise and organisation. Being in the private sector it will have the managerial and operational flexibility which the public sector units do not normally have and will be able to employ/hire the needed expertise.

Asset Reconstruction Fund

7.67 The ARF will be constituted with the objective of buying impaired loans from the weak banks and to recover or sell them after some reconstruction or in an 'as is where is' condition. The ARF will be a profit-oriented operation, its aim being to recover from the acquired assets (NPAs) more than the price paid for it.

7.68 The ARF may be set up by the Financial Restructuring Authority (FRA, discussed in greater detail in paragraphs 7.143 to 7.147) under a special Act of the Parliament. The Act, while protecting it against obstructive litigation from the borrowers could also provide for quick and effective enforcement of its rights against them. Some such special rights are enjoyed by State Financial Corporations (SFCs) and were also incorporated in the Industrial Reconstruction Bank of India Act under which the IRBI was constituted. The proposed fresh enactment would need to place the ARF in a better position to recover the loans as compared to the banks, SFCs and the erstwhile IRBI, for it is only then that the government will be successful in recovering at least a portion of the NPAs which the banks failed to recover.

Capital required for the ARF

7.69 Since under the proposed structure the ownership of the assets is sought to be kept with the government, the capital for the ARF would need to come from the government sources. However, the structure also retains the possibility of other institutional investors joining hands with government in providing capital for the ARF. They can join either initially as the ARF is being set up or any time later subject to the government's concurrence. The size of the capital needed for the ARF will depend upon the decision that is taken about the size of business it will handle. Presently, it is proposed that the ARF may restrict its activities to the NPAs of the three identified weak banks although it may also retain the option of dealing with NPAs of any other bank. This option may need to be exercised while considering taking over of a loan provided by banks in a consortium.

7.70 The NPAs of Indian Bank, UCO Bank and United Bank of India together amounted to Rs. 6,974 crore as on 31 March 1999. The Group feels that in order to ensure effective follow up and recovery of assets acquired, the ARF should, in the initial stages, focus on comparatively larger NPAs. It would, therefore, be desirable not to acquire assets valued below a minimum amount prescribed. To start with, this minimum amount may be kept at Rs. 50 lakh. Such NPAs of the three banks aggregated Rs. 3,336 crore as on 31 March 1999.

7.71 The ARF may, therefore, be required to acquire assets of the face value of about Rs.

3,000 crore. Past experiences of recoveries of bad loans indicate that it is generally possible to recover from loans which are more than three years old about 30 to 35 per cent of their face value. Recent experiences in South East Asian countries also have been similar and, presently, in Korea, the Korea Asset Management Corporation is reported to be buying secured impaired loans for 36 per cent of their face value. In other countries where the auction route has been adopted, such auctions have also fetched for bad loan prices in the range of 28 to 35 per cent of their face value. While conditions differ from country to country and prices will of course vary depending upon the quality of the NPA and the recovery environment, the Group feels that in our conditions also, as has already been experienced, average recovery remains within the range of 35 to 40 per cent of the outstandings. The price the ARF may be expected to pay would, therefore, be in this range and on the assumption that the aggregate NPAs hived off from the books of the three banks would be of the order of Rs. 3,000 crore, the capital needed by the ARF would be in the region of Rs. 1,000 crore.

Mode of payment

7.72 The payment in respect of the assets purchased from the weak banks may be made by the ARF by issuing special bonds for the purpose bearing a suitable rate of interest. It may also be guaranteed by the government in order to improve its liquidity. The bonds may, however, be issued to the weak bank with an initial lock-in period of at least two years so that its easy liquidity does not encourage the bank to enlarge its credit/investment portfolio aggressively even before the restructuring process has been completed and better credit and risk management processes have been firmly put in place.

Maturity of bonds issued by ARF

7.73 The bonds issued by the ARF in payment of the assets acquired as also those which it will issue for raising funds against the security of assets it has purchased and which are in the course of collection may have a maturity of five years. A maturity shorter than this may not be practicable as recovery of loans on an average is likely to take some time. At the same time, maturities longer than five years may also not be desirable because if a loan cannot be recovered by the ARF in five years from the date of its purchase, the chances of its recovery are really not good. There would then be no point in continuing with the bond and servicing it for an indefinite period.

Life span of the ARF

7.74 Not only the bond issued by the ARF but also the ARF should have a limited life. It should be able to complete its work, i.e., recover in full or part or sell the loans purchased by it within a period not exceeding seven years. It should not be envisaged that the ARF would buy NPAs from the banks on an ongoing basis and thus provide them with a ready avenue to dispose off their bad loans as and when these arise and the banks concerned choose to get them off their books. Such an arrangement would be a moral hazard because then the banks may not put in to their loan recovery efforts the kind of attention and diligence that is expected of them. They may also not pay due attention to acquiring and developing proper credit appraisal, monitoring and recovery skills. Recovery of its debt is a bank's own responsibility and normally it must undertake this activity without hoping to pass it on to any other agency even if it is prepared to bear some cost on this account. The Working Group, therefore, is of the view that the ARF should purchase from the banks loans, which are NPAs as on a certain date, say, 31 March 2000. The responsibility of recovering loans, which become NPAs after that date should remain totally with the banks concerned. In view of the foregoing it will be adequate for the ARF to have a life not more than seven years from the

date of its commencing business, say, beginning April 2000. Cross country experiences also show that ARFs/AMCs are generally for a limited period, thus the RTC in the United States had a life of seven years, while in Sweden which initially gave a life of fifteen years to the AMC subsequently reduced it to five years on account of improvement in the market conditions.

Banks to be covered by the ARF

7.75 In the first instance the ARF may buy NPAs only from the banks which have been identified as weak. To begin with, therefore, the ARF may buy NPAs of only the three identified weak banks, *viz*., Indian Bank, UCO Bank and United Bank of India. It would however not be desirable to preclude the ARF from buying loans from other banks, as this opening to the ARF for future need not be denied. Besides, there may be occasions when in the process of buying a particular loan from a weak bank in which the bank has been participating as a member of a consortium of banks, the ARF may find it desirable to buy out the shares of other members also in the consortium, which may not be weak banks. Furthermore, if the ARF is designed to accommodate NPA from other banks/ institutions this could increase the opportunity for more non-government participation in both ownership and funding.

7.76 The entity buying NPAs from banks has been conceived by the Group in the form of a 'fund' as, under this format, it would be possible to set up more such funds later if need arises. Such subsequent funds could be area-specific, bank-specific, for a group of banks or for the entire sector. Participation in these funds may be open to both public and private sector. As a secondary market for loans develops in the country, such funds are expected to become common.

Pricing of assets to be sold to ARF

7.77 The Technical Group, set up by the government to suggest an operating plan for ARCs, has recommended purchase of NPAs by an AMC in the private sector. It, therefore, had to take into account sensitivities attached to transfer of assets from public sector units to a private sector entity. For the same reason, it also considered it desirable for the bank selling the asset to set up a suitable floor price for disposal of the assets. While the Technical Group felt that a bank may not normally like to dispose of assets for less than 60 per cent of the latest value of the securities held plus five per cent of the unsecured portion of the loan, it did not prescribe any floor for pricing of assets. Its recommendation in this regard was that the banks may work out a suitable and detailed framework for deciding the floor price with the approval of the government and the Reserve Bank of India. It also recommended that transfer of any asset to the ARC should be well publicised indicating the amount due from the borrower and the securities held by the bank.

7.78 The aforementioned kind of sensitivity is not likely to arise in the structure suggested by the present Working Group since the ownership of the assets is proposed to be transferred to the government. In this context, it may also be mentioned that the guiding principle behind the structure suggested is that the asset acquisition by the ARF should not result in future losses for it. The price has to be, therefore, fair to both the buyer and the seller. The bank, however, while estimating a fair price for the assets to be transferred, must take into account the fact that it has so far not been able to recover the loan itself and that the time taken by the buyer to recover the loan would be indefinite. It would also be assuming the risk of recoveries being lower than the price paid.

7.79 The Group, therefore, noted that it would be difficult to prescribe rigid arrangements or a floor price for the transfer of NPAs and each case may have to be decided on merits taking into account the ultimate realisability of the assets realistically assessed on the basis of availability of securities, their present condition, the quality of documentation and the borrower himself. So long as pricing is arrived at by mutual agreement and in a transparent manner, the Group does not consider it necessary to prescribe either a floor price or a formula therefor.

Asset Management Company

7.80 The management of the ARF would be entrusted to an independent Asset Management Company. The AMC, a private sector entity, will employ and avail of the services of top class professionals experienced in asset recovery such as qualified valuers, chartered accountants, lawyers, M&A and reconstruction experts and experienced bankers. The AMC can be compensated for the services it provides in the form of service commission on the value of assets managed coupled with some incentives for recoveries if these are higher than an agreed benchmark.

Ownership of the Asset Management Company

7.81 In the ownership of the AMC, while the government would have a fair, may be even dominant, share up to 49 per cent, majority shareholding will be non-government. The other shareholders could be institutions like SBI, LIC, GIC, UTI and IFCI whose participation does not add to government shareholding and also parties from the private sector. The initial capital requirement of the AMC is not likely to be very high, say, not more than Rs. 15 crore and it would, therefore, not be difficult to attract non-government participants therein. It would also be possible to attract participation of multilateral agencies like IFC or ADB. The possibility of an existing fund manager in public or private sector offering to manage the ARF is also not ruled out. In fact, it may be desirable to explore this avenue.

Staffing of AMC

7.82 The AMC, being the manager of the ARF, would need to have the capability of evaluating the loans to be purchased taking into consideration the collateral held therefor, relative documentation and the overall recoverability of the loan. It should also have the expertise to take necessary measures for due follow up of recoveries including legal action. It follows, therefore, that it must be manned adequately by professionals such as bankers, chartered accountants, engineers, lawyers and valuers. Being in the private sector, it might not find it difficult to meet these diverse requirements at market related remuneration. It should also be possible for the AMC to take people from the banks in order to have the benefit of familiarity with the assets acquired and possibly carried-on institutional memory. The overall structure of the AMC is, however, expected to be lean in order that it retains a desired level of cost efficiency.

Impact of transfer of NPAs on the profitability of Indian Bank, UCO Bank and United Bank of India

7.83 To the extent that NPAs are taken off the books of the three banks and are moved on to the Asset Reconstruction Fund, the Fund would be paying them for the assets taken over by way of bonds bearing interest. This interest earning would add to the concerned banks' income. The amount of NPAs to be taken over by the ARF will, therefore, be important for each of the three banks.

7.84 The Group is of the view that the principle of using the public sector banks' median as the benchmark may be adopted in this case also. The gross NPAs of all public sector banks worked out to 15.89 per cent as on 31 March 1999. It would be desirable to assist the identified weak banks to reach a comparable benchmark of, say, 15 per cent. The table below gives the present level of NPAs and the reduction in terms of amount as well as a percentage of their total advances that will be required if they were to reach the aforesaid benchmark in respect of gross NPAs.

Table 14: Percentage of NPA reduction proposed (Amount in Rs. crore)

Name of the Bank	Gross Advances	Gross NPA	Percentage of (3) to (2)	15% of (2)	Amount of reduction desired (3 – 5)	Percentage of NPA reduction desired
1	2	3	4	5	6	7
Indian Bank	9,584	3,709	38.70	1,438	2,271	23.70
UCO Bank	7,610	1,716	22.55	1,142	574	7.55
United Bank of India	4,782	1,549	32.39	717	832	17.39

7.85 The quantum of gross NPAs which would need to be reduced from the aggregate NPAs of the three banks has been shown in Table 14 above. It is recommended that the banks should generally transfer out of their books NPAs above a minimum value, say, Rs. 50 lakh. The details of such NPAs in the books of the three banks as on 31 March 1999 are given below:

Table 15: Details of NPAs and provisions (Rs. crore)

	Indian Bank	UCO Bank	United Bank of India
NPAs above Rs. 50 lakh	1,979	696	661
Provisions already held	1,067	260	421
Net amount	912	436	240

While normally the banks may not transfer NPAs in the sub-standard category to the ARF, the decision in this regard will depend on the banks' assessment about their recoverability. It may sometimes also become necessary to include substandard loans in order to make a given lot of NPAs acceptable to the ARF and secure as best a price as possible. These are, therefore, not being taken out of the ambit of NPAs that could be sold.

7.86 For the loans transferred to the ARF, the banks would require to be compensated by the ARF and for such losses as they incur on these transactions there will have to be added recapitalisation. In effect, one way or the other, the banks will get bonds equal to the book value of the loans transferred. On this basis, and on the assumption that such bonds will carry an average coupon rate of ten per cent per annum, the incomes of the three banks, *viz*., Indian Bank, UCO Bank and United Bank of India, can be expected to be augmented by Rs. 91 crore, Rs. 44 crore and Rs. 24 crore respectively. Following this cleaning up of their books, they will also not be required to make any further provisions on these loans and the requirement of capital adequacy will also be reduced correspondingly.

Reduction in cost of operations

7.87 The cost of operations of the three banks is highly disproportionate to their levels of earnings. Cost income ratio of the Indian Bank, UCO Bank and the United Bank of India for the year 1998-99 worked out to 141.22, 93.94 and 97.61 respectively showing clearly that the cost of their operations has reached unsustainable levels and that, unless the situation is corrected immediately, survival of the three banks could be in jeopardy.

7.88 The cost structure of public sector banks in India is such that more than 70 per cent is accounted for only by staff costs. A table showing the ratio of staff cost to total operating expenses in 1998-99 is given in Annex 12 which shows that ranging from 58.03 per cent and 60.94 per cent in the case of Oriental Bank of Commerce and Corporation Bank respectively, it rises to a high of 81.29 per cent in the case of UCO Bank and 82.57 per cent in the case of United Bank of India. Quite clearly, when it comes to cost management and reduction, non-staff expenses are far less critical than staff expenses. Besides, these comprise of expenses incurred on items like rent and taxes, communication, printing and stationery and charges paid to professionals like lawyers, accountants and consultants. These are governed by market conditions over which banks have little or no control and, as long as the banks' need for these services is irreducible, there is very little room for reduction in these expenses.

7.89 Management of costs then necessarily boils down to management of staff expenses which in the year 1998-99 accounted for 76.37 per cent and 80.60 per cent of the total operating income (NII + all other income) in UCO Bank and United Bank of India respectively. If the likely impact of wage revisions is taken into account, this ratio in their case might go past 85 per cent. In the case of Indian Bank, the position was much worse which, as it is, showed a figure of 107.79 per cent. Such high ratios of staff expenses to total operating income show clearly that the banks are having to spend most of their available resources to meet only the staff costs and that there is little left to spend on business- related improvements particularly for making changes in technology, which does not come cheap. This is because of considerable overstaffing in the three banks. When we look at not very differently placed public sector banks which while working under comparable conditions have this ratio generally below 45 per cent, it is easy to gauge the handicap banks with the same ratio at a level above 75 per cent, are facing.

7.90 A picture of the extent of overstaffing at the three banks also emerges when we look at the ratio of assets to employees. A statement showing this ratio for all public sector banks as on 31 March 1998 is at Annex 13. The position with regard to the three identified weak banks is also given below:

Table 16: Asset to employee ratio as on 31 March 1998

	Indian Bank	UCO Bank	United Bank of India
Assets (Rs. crore)	19,454	18,586	14,389
Officers	9,440	8,795	5,855
Clerical	13,514	16,928	11,076
Sub-staff	4,040	7,107	5,110
Total employees	26,994	32,830	22,041
Asset/Officers	2.06	2.11	2.46
Asset/Clerical	1.44	1.10	1.30
Asset/Sub-staff	4.82	2.62	2.82

Asset/Total employees @	0.72	0.57	0.65

@ Median for all public sector banks excluding the three weak banks was 0.72.

7.91 The highest ratio of assets to employees in public sector banks in the year 1997-98 was that of Corporation Bank at 1.17. Oriental Bank of Commerce and Bank of Baroda followed with 1.04 and 1.00 respectively. While in public sector banks as a class the ratio of employees to assets is nearly seven times higher than in foreign banks, compared even to other public sector banks, the three banks are clearly overstaffed and are at a considerable disadvantage.

7.92 The balance sheets of the three banks will contract immediately after restructuring as substantial amounts of NPAs will move out of their books and the banks will also take steps to shed high cost liabilities. In the initial years after restructuring, the three banks will find it necessary to reduce intake of high cost liabilities until restructuring of the asset portfolio is complete and they have acquired skills and competitive abilities to deploy all the resources they can raise and build a sound and profitable advances portfolio.

7.93 It may be added in this context that while deciding whether or not there is overstaffing one should look at the issue not only from the angle of the total number of employees handling a certain quantum of business (asset/ employee ratio) but also from the angle of the bank's operating income which gives it the ability to bear the relative costs. In fact, the latter consideration deserves a greater weightage as it provides an explanation why some banks which have a low assets to employee ratio or a high staff expenses to total income ratio are still able to record profits and appear to have better chances of survival. Their ability to generate higher net incomes and, therefore, a healthier cost to income ratio keeps them away from the disaster line.

7.94 The table contained in Annex 14 to the report shows how big a proportion of a bank's overall income (all interest + non-interest income) goes towards meeting the staff cost alone. Banks which have to allocate a comparatively lower proportion of their overall income towards their staff costs have much greater flexibility and competitive advantage over others not so well placed in this regard. As competition intensifies, they can be expected to withstand falling margins and can also afford to incur expenditure for creating and supporting new businesses.

7.95 The Working Group has examined carefully the possibilities of the income of the three banks rising substantially in the near future and, for the reasons detailed in Chapter 6 of the report, is of the view that this is not feasible. There are clear portents that unless a significant restructuring as suggested herein takes place, high staff expenses will continue to keep their operating expenses close to or even in excess of their operating income.

7.96 The proportion of staff expenses to total operating costs in the three banks is quite high and indicates clearly that resources spent on employees are disproportionate to the bank's current ability of earning. The ratios of staff costs to total income (including interest income and excluding interest income) of the three banks for the years 1997-98 and 1998-99 are given below:

Table 17: Staff Cost to Total Income and to Operating Income

	Staff Cost to Total Income		Staff Cost to Operating Income	
	1997-98	1998-99	1997-98	1998-99
Indian Bank	23.48	23.40	124.86	107.79
UCO Bank	27.07	25.74	80.19	76.37
United Bank of India	22.67	22.26	72.23	80.60

The table containing these ratios for all twenty-seven public sector banks is at Annex 14 and Annex 8 (G). It is noteworthy that the ratio of staff cost to operating income of these three banks are the highest in the industry. The median value of this ratio for 24 public sector banks (excluding the three weak banks) was only 46.58 viewed against which the ratios of these three banks indicate an unsustainable position. The three banks, therefore, have little choice but to take all possible measures to reduce their staff costs and bring it in line with at least the average performing public sector banks in terms of its percentage to total operating income (net interest income + non-interest income).

7.97 It needs to be kept in view that the three banks have not factored in the wage revision that is to become effective from November 1997. No provision in respect of the increase (12.25 per cent) has been made and should it become applicable to them not only will the yearly wage bill for the future years go up but substantial amounts will also go towards arrears for the period beginning from the date from which the revision becomes effective in their case. Further, these revisions have been made every five years which implies a possibility of yet another upward revision effective November 2002. With a possibility of yet another increase becoming applicable to the staff costs of the three banks only about three years down the line, the unsustainability of their current mode of operations becomes evident.

7.98 How can the three banks go about reducing their staff costs and bring it to a reasonable level vis-à-vis their income? Waiting for the income to go up or for the costs to come down as a result of natural attrition that will take place in the next four to five years is not a feasible solution because neither the growth in income is expected to outpace the growth in cost of staff at current levels nor is the likely natural rate of attrition in staff strength such that can make a real dent in the costs. The three banks are, therefore, faced with a Hobson's choice, a choice between sinking to unviability and reducing their expenditure on staff either by reducing the number of employees or by effecting a reduction in per employee cost.

7.99 The size of the reduction in the number of employees is an issue which has to be addressed very carefully. Considering the human angles involved, it must be kept to the minimum. At the same time, it has to be ensured that it does not end up as a token exercise with little or only a marginal reduction in costs failing to alleviate the pressure on viability in any significant manner. The objective will be served only if the reduction is of an order that will bring the staff cost ratios to at least the median level in public sector banks, a level without achieving which the three banks cannot expect to gain any competitive efficiency and a chance to survive as viable units. The table below gives the present number of their employees, the relative expenses, the resultant ratio of staff costs to total operating income, the median level of this ratio in public sector banks, and the estimated reduction in the staff costs which can be expected to improve this ratio in the three banks to the level of the median of public sector banks.

Table 18: Required reduction in staff cost (Amount in Rs. crore)

Name of the Bank	Total staff cost	Staff cost to total operating income (%)	Median for public sector banks (%)	Staff cost to total operating income at median level	Required reduction in cost to reach median level
Indian Bank	427.00	107.79	46.58	184.52	242.48
UCO Bank	483.96	76.37	46.58	295.18	188.78
United Bank of India	340.84	80.60	46.58	196.98	143.86

7.100 The banks will also get some income on the bonds they receive as payment for their NPAs sold to the ARF as discussed in paragraph 7.86 above. This added income will help them meet some part of staff expenses and to that extent curtailment in staff strength can be avoided. The requirement of staff reduction would, therefore, get suitably modified. The following table shows the modified requirement of reduction.

Table 19: Required reduction in staff costs after NPA transfer

(Amount in Rs. crore)

Name of the Bank	Total staff cost	Required reduction in cost to reach median level	Estimated positive financial impact o/a of NPA transfer	Required reduction after adjusting NPA transfer	Resultant required reduction in staff (%)
Indian Bank	427.00	242.48	91.00	151.48	35.5
UCO Bank	483.96	188.78	44.00	144.78	29.9
United Bank of India	340.84	143.86	24.00	119.86	35.2

7.101 It may be mentioned in this context that a committee constituted by the Board of Directors of the UCO Bank has also identified a similar surplus in that bank. The other two banks do not appear to have made any such estimate formally. However, in the Group's view, the extent of reduction required is high and, considering the impact a sudden reduction of this magnitude will have on the operations of the bank, does not appear immediately feasible. Also, the net operating income of the bank is expected to grow every year even if not very substantially and would provide some further cushion for the staff expenses as long as the banks ensure that the present staff strength and the relative expenses remain capped. Considering all factors involved, the Group is of the view that initially a reduction in the staff strength of the order of 25 per cent may serve the purpose and should, therefore, be aimed at. It is expected that with the cost control and business improvement measures the banks are being asked to take up, there will be no need for any further precipitate reduction in staff strength and that natural attrition would take care of the reductions called for. If, however, the banks fail to increase their business and income base urgently, say, within the next two years even after the 25 per cent reduction, the picture will be quite different.

7.102 A 25 per cent reduction in staff strength would help the banks reduce staff costs correspondingly. This going by the expenses incurred in the year 1998-99, would work out approximately to Rs. 107 crore, Rs. 121 crore and Rs. 85 crore annually in the case of Indian Bank, UCO Bank and United Bank of India respectively. These amounts are substantial and, with the results of business restructuring flowing in, will provide the banks the necessary

leverage to attain the needed turnaround.

7.103 This step, although appearing to be drastic, is in the opinion of the Working Group, unavoidable. An effort to continue with the present strength for the next few years could jeopardise the survival of the three banks. The choice, therefore, is between reducing the staff strength now and protecting the bank's future and not going in for the reduction and endangering its survival. In this connection, it may be mentioned that bank restructuring elsewhere too has necessitated drastic reduction in staff strength. Thus, for example, in Korea, the number of bank employees decreased by 34 per cent as of end-1998, compared to end-1997. The number of branches decreased by 17 per cent during the same period. China too has undertaken a similar exercise.

7.104 The Group is, therefore, of the opinion that in order to control their staff costs, the three weak banks will have to resort to a voluntary retirement scheme (VRS) covering at least 25 per cent of the staff strength. Recent experiences with VRS at some public sector organisations show that these schemes if structured properly and addressed to the staff with understanding can be quite successful. BHEL reportedly had to close their VRS within 24 days of its introduction when against the intended 5,000 applications, it received 7,000 applications. In the present situation of the three banks, such a scheme is expected to be seen by many as a good compromise and an acceptable exit avenue.

7.105 An exercise of this order is bound to be cost intensive and it is estimated that reasonable VRS for the three banks aimed at 25 per cent reduction would cost anywhere between Rs. 1,100 and Rs. 1,200 crore. At the first look, the amount appears high but as a permanent solution to one of the main problems faced by the three banks, it is unavoidable and, in the interests of restructuring the banks successfully, should be acceptable.

7.106 The Working Group recognises that the level of reduction in staff costs which is being suggested is the absolute minimum. It also needs to be mentioned that the rightsizing of staff will have to be achieved by the individual banks structuring their schemes in such a way that they are able to maintain the required balance between the different categories of staff and do not lose the desirable experience and skills they possess. While the Group does not propose to recommend the specifics of the VRS, the following main elements may need to be built therein care being taken, as far as practicable, to ensure that even after his/her voluntary retirement, the employee can lead a life of economic independence and dignity.

a. The scheme will have to be voluntary but the right to accept or reject individual applications should rest with the management of the banks.
b. The scheme should aim at separation of employees in the age group of 45 and above especially those in the 50-55 age group.
c. The scheme should be in operation for a period not exceeding six months with discretion of early closure.

The scheme must be implemented with care and compassion to guard against avoidable pain which is likely to accompany such separation. The banks introducing VRS should try and assist the separating employee in his/her post-retirement planning. While expert advice on the handling and proper investment of the amount of compensation under the scheme should be provided readily, the banks could also consider outsourcing select services from their employees availing of the VRS. Some banks are already availing of services of outside agencies in deposit mobilisation, follow-up and recovery of debts and conduct of different kinds of field surveys. These and similar other activities can be outsourced through properly organised groups of employees going out under the VRS. Banks may consider assisting the

employees in forming suitable organisations for the purpose.

7.107 Alongside operating Voluntary Retirement Schemes, the three banks will also need to undertake considerable retraining and relocation of the post-VRS staff strength. The banks will have to ensure changes in the job content and skills of the different categories of employees so that their services can be put to best use at points where these will be needed most in accordance with the changed operating strategies of the banks concerned. Such reskilling and relocation should be made a precondition for future recapitalisations.

Capping staff costs

7.108 In order that the VRS and the needed reduction in staff costs have a real impact on the operating results of the banks concerned, it would also be necessary to place a cap on the staff expenses of the three banks. Towards this, the Working Group recommends that a freeze on all future wage increase including the one presently under contemplation, i.e., with effect from November 1997 be put in place. This may continue for a period of five years.

7.109 It should also be understood in this context that the main objective behind the introduction of VRS in the three banks being a sizeable reduction in their operating costs, the scheme would need to be successful within a reasonable period. This cannot be allowed to become one of those schemes which are introduced but in effect remain dormant. If VRS does not lead to the needed reduction in the banks' operating costs, there will be no alternative left but to resort to an across-the-board wage cut of an order which will result in a similar reduction in costs. It is with this urgency in mind that the Working Group has suggested keeping the VRS open for a limited period of six months.

7.110 To the employees of the three banks, these suggestions are bound to appear precipitate and harsh. It may be argued that they are being unfairly singled out and are having to 'pay for' what is not their doing. To a certain extent, it may appear to be so but at this point of time, none of the parties involved, viz., the government, the bank or the employees are left with any choice. Wherever the fault may lie, the fact of the matter is that the banks are unable to earn the kind of income which is required for sustaining their present staff expenses. The only other source of sustenance in these cases is recapitalisation support from the government but this too is not readily available because of the increasing pressures and other compelling demands on the government's resources. If, therefore, the banks are to survive, most efforts and sacrifices will have to be their own. Outside support can only be limited and will be predicated upon what the three banks can do themselves. Estimated cost of operational and financial restructuring

7.111 The overall cost of restructuring the three banks over the next three years is estimated by the Working Group to be of the order of Rs. 5,500 crore. A purpose-wise breakup of the required amount is given below.

a. Technology upgradation @	Rs. 300-400 crore
b. VRS @	Rs. 1,100-1,200 crore
c. NPA buyout	Rs. 1,000 crore
d. For capital adequacy	Rs. 3,000 crore

@ Funds for (a) and (b) will have to be provided in cash.

Out of the Rs. 3,000 crore required for capital adequacy, approximately Rs. 968 crore is the

immediate requirement of the Indian Bank to achieve the needed CAR of nine per cent. In the next three years, additional requirements of the three banks for CAR are estimated to be in the region of Rs. 2,000 crore.

7.112 The above estimates are based on the projection of the concerned banks' operations in the next three years ending March 2003 which in turn have been based upon their present operations and likely changes/improvements therein in the course of their restructuring. It has also been assumed that the restructuring programme will begin no later than April 2000 and the necessary additional recapitalisation and other supports by way of NPA takeout and technology upgradation will be completed within a timebound schedule. The estimate could turn out to be inadequate if some hidden surprises surface or some delays or other roadblocks are encountered in the course of implementing the programme. However, the final figure is not likely to be very far out of the estimate presented above.

Organisational Restructuring

Administrative structure

7.113 Most of the public sector banks, because of the rapid pace of the expansion of their branch network and the vast geographical area that is covered by them, have a fairly complex administrative structure. The report of the CBSR also has pointed out that, as a result of expansion and the complex administrative structure, the efficiency of the three banks has suffered. It was pointed out by the CBSR that "lines of command and control have lengthened to the point of weakening of central office supervision without effectively decentralising decision making and operations". This continues to be a limitation with all public sector banks and in the weaker banks it is proving to be even more worrisome. In the three banks, the decision making process has been totally impaired and while it is multi-layered, each of these layers is delay laden and without any clarity of policies and purpose.

7.114 At some banks, some attempts at organisational restructuring have been made in the recent past, UCO Bank being one of them. The Group, which had an occasion to study UCO Bank's working, did not however notice any marked improvement in or shortening of the decision making process. Although there is reportedly some delayering in the process, the administrative structure continues to be diffused. It may be added in this context that delayering alone would not speed up decision making unless other essential preconditions like clearly laid out policies and procedures, skills and adequate discretionary powers are available at the different levels of decision making. The management of the concerned banks and their respective Boards would need to pay urgent attention to this issue without which loss of business will be very difficult to arrest.

Branch network

7.115 Another important organisational issue concerning the weak banks is the spread of their branches. Indian Bank, UCO Bank and United Bank of India have 1492, 1790 and 1333 branches respectively with an average per branch business (advances + deposits) level of Rs. 14.67 crore, Rs. 10.08 crore and Rs. 12.69 crore respectively during the year 1998-99. The corresponding figure for public sector banks works out to Rs. 17.28 crore. It would, therefore, appear that the three banks have a larger network of branches than what their level of business calls for. Besides the sustainability of this large a branch network with their current levels of business, there is the question of concentration of branches in specific areas with which United Bank of India and UCO Bank are faced. At a fairly large number of centres,

branches of the same bank are only eating into each other's potential of business without contributing by their presence in any significant manner to the total potential of business available for the bank. There is, therefore, an urgent need to consider rationalisation of branches in all the three weak banks. Such rationalisation is also expected to help the three banks in much needed cost reduction. It is understood that UCO Bank has already embarked upon such a plan. It is time that the other two banks as well think on these lines.

7.116 An area-wise analysis of the per branch business of the three banks as compared to other banks is given in Table 20. It may be seen that under all the categories, i.e., rural, semi-urban, urban and metropolitan, the branches of the Indian Bank, UCO Bank and United Bank of India have, on an average, lower per branch business levels as compared to the branches of nationalised banks. While in the case of the UCO Bank, the difference between the average business levels at their branches and the branches of the nationalised banks is quite sizeable, going up to over 40 per cent, in the other two banks also the business level of their branches is lower by about 25 to 30 per cent. The high NPA level at most of these branches aggravates the problem further. Many of these branches are, therefore, for obvious reasons making losses and are not likely to become profitable in the foreseeable future.

Table 20: Area-wise business of Public Sector Banks as on 31 March 1999

(Rs. crore)

	State Bank Group	Nationalised Banks	Public Sector Banks	Indian Bank	UCO Bank	United Bank of India
Rural						
Deposit	23,794	55,512	79,307	1,537	3,136	2,807
Credit	10,012	21,176	31,188	765	908	727
Total business	33,806	76,688	1,10,494	2,302	4,044	3,534
Branches	5,509	13,922	19,431	538	892	671
Business per branch	6.14	5.51	5.69	4.28	4.53	5.27
Semi-urban						
Deposit	48,668	68,141	1,16,809	3,092	2,476	2,477
Credit	18,740	21,570	40,309	967	611	471
Total business	67,408	89,711	1,57,118	4,058	3,087	2,948
Branches	3,926	6,714	10,640	376	278	202
Business per branch	17.17	13.36	14.77	10.79	11.10	14.59
Urban/Metropolitan						
Deposit	99,320	2,61,046	3,60,366	11,213	8,480	8,581
Credit	85,679	1,46,235	2,31,914	6,010	4,322	3,571
Total business	184,999	4,07,281	5,92,280	17,223	12,802	12,152
Branches	3,855	11,672	15,527	581	620	460
Business per branch	47.99	34.89	38.15	29.64	20.65	26.42
All India						
Deposit	1,71,782	3,84,699	5,56,482	15,842	14,092	13,865
Credit	1,14,430	1,88,980	3,03,411	7,741	5,841	4,768
Total business	2,86,213	5,73,680	8,59,892	23,583	19,933	18,634
Branches	13,290	32,308	45,598	1,495	1,790	1,333
Business per branch	21.54	17.76	18.86	15.77	11.14	13.98

7.117 It may be added in this context that most public sector banks are not following a scientifically developed objective transfer pricing system between their branches and branches and the administrative offices. In some cases, the transfer pricing policy has often

been modified to suit a particular type/group of branches so that the number of loss making branches could be brought down. Such an effort is really pointless. It does not change the overall profitability of the bank. Nonetheless, some banks seem to prefer the approach, at least, to be able to show that the number of their loss making branches is not very high. In the circumstances, the Group, after due consideration, has come to the conclusion that branches of these banks which are more than five years old but at which business levels are still less than 50 per cent of the average per branch business levels in the same category of branches in the nationalised banks should be merged with another branch of the bank. Merger with a nearby branch of another nationalised bank can also be considered. Such branches are clearly unviable and little purpose would be served by continuing to incur costs thereon. Having not achieved even 50 per cent of the average business level of branches in the same category of all nationalised banks, most of these non-performing branches are unlikely to improve their business prospects and will continue to be a drag on the weak banks' profitability.

7.118 The weak banks must, therefore, take a hard and careful look at each one of these branches and after convincing themselves about their unviability decide to discontinue these operations. By continuing such operations, hoping that these will improve in future or by showing them artificially as profitable using a transfer pricing mechanism which favours them unduly, the problem will be compounded and elude solution even in future. It therefore stands to reason that the banks merge two or more unviable operations into one viable operation. As long as the banking requirement of the clientele and the area served by the unviable branch can be met by another branch of that bank or any other bank, in the immediate interest of the weak banks and long term interests of the Indian banking system unviable branches should be closed.

Top Management

7.119 The working of the top management in weak banks is seen to be constrained by both internal as well as external factors due to which it has not been able to respond to the stiff challenges faced. Absence of dynamic leadership for long periods has been a major contributory factor to the consistent deterioration in the functioning of these banks. Considering the future changes and challenges that are likely to be faced by the banking sector in general and the weak banks in particular, the Working Group is convinced of the need for appointment of CMDs who are especially suited to their jobs. The concept of differentiating between war-time generals and peace-time generals holds good here as well and the Group is of the considered view that the CMD in a weak bank has to be in the nature of a war-time general possessing special skills and attitude helpful in restructuring of an organisation. Incumbents in these positions need to be proven achievers who can lead from the front.

7.120 It is equally important that the CMDs of these banks have a sufficiently long tenure, say, a minimum of four to five years for effectively discharging the complicated task of restructuring a bank and should evidently be in the age group of 50-52 years. In order to ensure uninterrupted progress of the restructuring plan and to commit the top management thereto fully, this tenure may not be ordinarily curtailed.

7.121 The Group has also received suggestions and agrees with them that the right persons for these jobs should be provided with incentives, both monetary and non-monetary, for achieving the restructuring mission successfully even if giving such incentives means making a departure from the existing norms. In such cases, a higher package of remuneration and special performance bonuses made payable on achievement of specified performance targets built into the restructuring plan are worth serious consideration.

7.122 There could be other ways as well for providing incentives for talented and ambitious persons to take up the arduous task of restructuring weak banks. If in the four or five year career of a person as CMD of a weak bank the bank shows a definite improvement, he could be considered for heading one of the prime banks/financial institutions in the country. It would not be necessary to make this kind of provision a part of the contract, but in exemplary cases, the point could be well made by setting precedents. Such a step would go a long way in removing the kind of hesitation or even stigma that is felt by people working in the weak banks and would motivate them to face the special challenges before them with greater willingness, determination and belief in the future. It must however be added in this context that the best incentive would still be financial and a way would need to be found to remunerate the CMDs and EDs of banks undergoing restructuring for regaining their competitive efficiency.

7.123 Presently, public sector banks have only one position of Executive Director. Also, experience shows that an Executive Director seldom succeeds the outgoing CMD in the same bank. The Group found that this arrangement creates a sense of non-involvement in the bank's affairs on the part of the ED. The CMD, on the other hand, develops a feeling of isolation and finds it difficult to build a team. A distance between the top two functionaries of a bank always works to the detriment of the organisation. The Group, therefore, feels that in at least the weak banks, a line of succession should be developed well in time and a system put in place whereby, save exceptions, an ED should succeed the outgoing CMD. The Group also feels that excepting in very small banks, there should be two EDs. This should be more so in weak banks where a very senior functionary, besides the CMD, should be charged with the responsibility of driving the restructuring process leaving the CMD free to pursue other strategic growth issues.

Board of Directors

7.124 The role of an active board in planning comprehensive strategies to steer past the various hurdles is critical in weak banks. The boards of these banks need to be reconstituted to include eminent professionals, industrialists and financial experts with the necessary training, experience and background to provide strategic support to the CMD's team. Based on the experience of working of these boards, there is a general view that the present constitution of the banks' boards admits a review, especially in the weak banks where the board has a special role to play in guiding the banks out of trouble. The Working Group is in agreement with this view. In these cases board level support to the banks' management in strategising, decision making, target monitoring and course corrections have to be regular and extensive and the board needs to possess not only the talent and will but also a cohesive and focused approach to do it. It is important for the weak banks that their boards function as totally cohesive bodies.

7.125 In this context, the Working Group is of the view that the presence of government directors has been more of a disadvantage in the working of the boards of public sector banks. Because of their position in the government and more specifically because the government's role as the owner of these banks gets stressed in one way or the other, government director's domination in the proceedings of the boards becomes almost automatic. In most cases, the other members of the board look for a signal from the government director and for one reason or the other chose to follow the line adopted by him. On occasions, when the government director is not able to attend the board meetings, important decisions tend to be postponed. In the interest of proper working of the board of banks and more so in the interest of the boards assuming at least some degree of

responsibility for adding shareholder value and being accountable for their decisions, Government of India needs to consider withdrawing its functionaries from the banks' boards. There should be a clear distinction between the two roles, the one relating to ownership, which the government has, and the other relating to management, which it does not. It may be argued that the government functionary is only watching in the board the interests of the majority/sole shareholder. But, if such a watch impinges upon independent thinking and working of the boards, it becomes counterproductive and runs against the government's own long term interests. As a first step in the direction, therefore, the government may consider withdrawing from the banks' boards its own serving officers and replace them with independent nominees having relevant knowledge and background in the area of operation of the unit concerned. Such nominees will not have the force and authority of any position in the government and would then be treated by the members of the board as their equal.

Human resources

7.126 There is apparently room for staff restructuring in the three banks. It is possible to take a view that with increase in business and earnings, this position could improve. However, an analysis of the situation undertaken by the Group has shown that there will be important preconditions to fulfil before the three banks can expect to register any sizeable increase in their earnings.

7.127 The leadership at the middle levels in the three banks is seriously lacking. This is largely because of inadequacies in skills both in traditional areas of banks' operations as well as the new areas in which most banks are now moving. In specialised areas like credit, treasury operations, foreign exchange and, of course, IT, the three banks are extremely deficient in skills and are almost out of the market. A bank like the United Bank of India, with nearly 1,300 branches, has an income level of only about Rs. 8 crore per annum from foreign exchange business. Similarly, any of these three banks has hardly any treasury product to offer to its clients and so far as information technology is concerned, it has hardly been introduced.

7.128 The banks quite clearly need considerable assistance in these regards and while a longer term training and reskilling programme will have to be undertaken by them, they would also need to resort to some recruitment in the senior and middle levels of management from the market. Provision would need to be created for such recruitment by them. Without such recruitment and lateral movement of talent, the three banks will find it extremely difficult and time consuming to develop the much needed skills for entering and operating in the emerging areas of banking business.

7.129 As has been mentioned earlier, the training facilities available in the three banks are inadequate to meet the needs that would now arise following the restructuring efforts. These will, therefore, have to be considerably strengthened. It is also worth considering whether training facilities created by more than one bank should be pooled for better utilisation of the facilities created and optimum utilisation of the limited training skills available. This would also lead to improved consistency and quality of training. The Group has suggested earmarking a part of the capital support for HR activities including VRS. A sub-allocation out of this earmarked capital support may be made for re-skilling and training.

Financial restructuring

7.130 Financial restructuring has to be undertaken to ensure the solvency of the three banks. Reserve Bank of India's regulatory norms require banks to maintain a CAR of eight per cent.

This is being increased to nine per cent with effect from the current year ending 31 March 2000. In the past, the Government of India has had to bring in Rs. 20,446 crore to provide as capital to the nationalised banks so that they could meet the prescribed CAR norms. Out of this, capital infusion in the three identified weak banks has accounted for Rs. 6,740 crore. Individually, their share till 31 March 1999 was as under:

Table 21: Aggregate capital provided, accumulated losses and CAR

	Indian Bank		UCO Bank		United Bank of India	
	1998	1999	1998	1999	1998	1999
1. Aggregate capital (Rs. crore)	2,575.90	2,675.90	2,056.52	2,256.52	1,708.06	1,808.06
2. Accumulated losses (Rs. crore)	2,403.38	3,181.88	1,736.00	1,803.90	1,424.45	1,409.75
3. CAR	1.41	(-) 8.94	9.07	9.63	8.41	9.60

7.131 With the above capital infusion while UCO Bank and United Bank of India were able to meet the minimum CAR requirements, Indian Bank's requirement of capital being much higher, it failed to meet the prescribed norms at the end of the financial year 1997-98 as well as 1998-99. This is, as shown above even after the massive capital infusion to the extent of Rs. 6,740 crore already received by them. It has, in effect, been operating for the whole of 1998- 99 without meeting the regulatory requirement of minimum capital adequacy.Further capital infusion in its case is, therefore, imperative to ensure that it continues business operations normally.

7.132 Although due to its government ownership, and largely due to lack of understanding of these issues on the part of the average depositor, the deposit taking activity of the Indian Bank does not appear to have suffered so far, this situation cannot be expected to last too long. In future, if the bank's capital adequacy is not corrected even its deposit taking ability may suffer.

7.133 An effort has been made in paragraph 7.111 to give a break up of these requirements purpose-wise. In this context, it needs to be mentioned that the banks, in order to be able to attract good business, will need capital in excess of the minimum required. With minimum permissible level of capital adequacy, they can hardly scout for and expect to book additional business which will necessitate their having more capital. Experience has shown that once a bank's CAR is close to the minimum, it starts shunning new business. Good and larger clients also begin looking elsewhere as they know that the bank is no more in a position to meet their additional requirements of credit.

7.134 Marginal CAR also affects the asset portfolio of a bank as in this situation it will prefer to book assets which bear zero or very low risk weights and do not attract requirement of capital. The asset build up of the bank, then, shows heavy preference towards government papers which, though bearing zero risk weight, have much lower yields as compared to its own advances portfolio. This will obviously affect its earnings.

7.135 For maintaining a good loan book as also a balanced overall asset profile, banks need to maintain at all time CAR at a level comfortably above the minimum required. The Working Group is, therefore, of the view that at financial restructuring of a bank should aim at raising its CAR to at least one per cent above the minimum required so that it can continue with its credit business normally.

7.136 So far, the government has used recapitalisation bonds as the instrument for recapitalisation of banks. While some of the initial issues bore a coupon rate of 7.75 per cent per annum, subsequent issues were with a 10 per cent coupon. The Group is of the view that to the extent immediate cash funds are not being made available to the banks, this mode of capitalisation may be continued.

7.137 In the restructuring plan for the weak banks, which is proposed by the Working Group, a portion of the additional capital requirement would need to be provided in cash. The question of its servicing also needs to be considered very carefully. So far, they have not had any motivation to service the capital provided to them. This, as pointed out earlier, has acted as a serious moral hazard and has affected their performance. The Group, therefore, feels that as a measure of introducing some accountability for using additional funds, the weak banks must undertake to provide a return. At least, on such portion of capital funds, which are provided in cash/by transfer of funds, there needs to be an arrangement, even if deferred, for payment of interest. The government may decide to bring in such capital by way of preference capital or subordinated debt forming a part of Tier II capital of banks on which the recipient banks may be required to pay interest.

7.138 One of the most important reasons for the weak banks not succeeding in improving their performance has been the unconditional recapitalisation support received by them so far. The bank management and the staff have always felt confident that, whatever be the bank's performance, its need for additional capital to keep it afloat will always be forthcoming from the government. There has been, therefore, very limited effort to build good business, increase earnings and to reduce cost. Memoranda of Understanding entered into with the Reserve Bank of India and even the Strategic Revival Plans, which were prepared by the banks themselves at the instance of the Government of India, have failed to serve the purpose. Year after year, the three banks have failed to meet most targets and undertakings contained in these documents.

7.139 Considering the banks' past performance, the Working Group has come to the conclusion that any further recapitalisation of weak banks must be accompanied by strict conditionalities relating to operating as well as managerial aspects of the recipient bank's working. There should also be conditionalities about the manner in which these funds can be deployed and about their servicing. The banks concerned need to recognise that they have an obligation to service the capital and that therefore their demand from the government for additional capital without any limit is just not sustainable.

7.140 In the assessment of the Group, the weak banks will be needing additional capital to meet the following requirements:

a. moving some portion of the NPAs out of the books,

b. cost of modernisation of technology,

c. HRD related costs including that of VRS, relocation, training and skill building exercises that would have to be followed in the course of restructuring,

d. capital adequacy.

Funds required for items under (b) and (c) will have to come by way of cash and cannot be provided in the form of bonds as has been done so far. Requirements for items under (a) and (d), however, can be met through bonds as hitherto.

7.141 The Group is of the opinion that future capital infusions in weak banks should be clearly earmarked for specific purposes indicating the amount that could be used under the head as also the period within which it could be utilised. For the portion of capital infusion, which will be by way of actual transfer of funds, the arrangement should be such that the funds become available only when the banks undertake the specific activities for which these have been earmarked. An account with the government or with the RBI could be opened from which earmarked funds could be made available. As indicated in paragraph 7.137 above, for the present, this arrangement would extend to modernisation of technology and specified HR related expenses.

7.142 The concept of payment of interest on capital funds that may now be provided in cash/transfer of funds, is sought to be introduced not so much because the government must get a return on the funds provided but mainly because the recipient banks' management should factor in this obligation in the cost of their operations. Some of these banks have been expressing intention of accessing capital markets for long term debts to serve as part of their Tier II capital. If they are successful in their efforts and raise the funds, they will no doubt have to service such debts at a high cost. If, therefore, they were to receive funds from the government, there is no reason why these must be cost-free. However, considering their present financial condition, the government may decide to give them moratorium on payment of interest for one or two years, i.e., until the deployment of these funds starts getting reflected in their operating results. The agreed rate of dividend on such preference shares and interest on subordinated debt may not be market-related and kept low. It may even be so structured that, in the initial years, the rates may be lower, rising only after the bank's earnings are expected to grow. The point that needs to be made is only that there must be an obligation on the part of the bank using the funds to recognise these as cost bearing.

7.143 In paragraph 7.136 above, the need for any further capitalisation being accompanied by strict conditionalities has been stressed. In the foregoing paragraphs, some of those conditionalities have been suggested. In general, it is also felt that all future recapitalisation should be under an agreement, between the government on the one side and the bank's Board of Directors, its management and staff and employee unions on the other, laying out the restructuring goals. The agreement, while stating clearly the extent of government's involvement and the responsibilities of the bank, should also contain details of the bank's obligations to perform and report, precise milestones for performance and measures that will follow non-performance, treatment of NPAs and near term improvements in operating results. It would also be desirable to assign selected financial indices for the bank to follow within a timeframe. The performance under this agreement will have to be monitored closely. The Group's recommendations regarding the agency, which could be entrusted with this kind of follow-up, are contained in detail in paragraphs 7.143 to 7.147.

Systemic Restructuring

Setting up of a Financial Restructuring Authority (FRA)

7.144 Based on past experiences of implementing bank restructuring programmes in

different countries across the world, it is considered necessary that an independent agency be entrusted with the responsibility of monitoring the progress of any such programme being put in place. The role and importance of an independent agency in driving a restructuring programme and monitoring its progress constantly has been discussed earlier in paragraph 7.4 (e) of this report.

7.145 In most cases where bank restructuring programmes have been undertaken, setting up of such an agency has been found essential. In Korea, this issue was addressed by setting up a new bank supervisory body, i.e., the Financial Supervisory Commission (FSC). While taking over the regulation of financial institutions from the Ministry of Finance and Economy (MOFE) and the Office of Bank Supervision (OBS) of the Bank of Korea, the FSC also undertook the responsibility of conducting the programme of bank restructuring. For achieving this objective, it established the Financial Restructuring Unit to oversee and coordinate the financial restructuring. In Thailand, the programme has been handled by setting up of the Financial Sector Restructuring Authority (FSRA) by the Ministry of Finance. The role assigned to FSRA in Thailand was to assume control of and liquidate the suspended finance companies. In Indonesia, restructuring is managed by a special agency set up for the purpose, i.e., Indonesian Bank Restructuring Agency (IBRA) which is a division of the Ministry of Finance. It has been given the responsibility of resolving non-performing loans. An Asset Management Kredit (AMK) has been set up within IBRA to receive bank assets including NPAs. Even in one of the earlier restructuring programmes undertaken in Sweden in the early 1990s, a separate restructuring agency known as the Bank Support Authority (BSA) was set up. It has thus been a common feature across the countries attempting restructuring of banks/financial institutions to set up a special agency which runs the restructuring programme monitoring its progress bank-wise while the banks themselves implement their respective plans. Obviously, existence of such an agency facilitates coordination between the different entities which are being restructured as also between the owners, the government and the regulatory authorities.

7.146 The Working Group is of the view that in order to ensure success in restructuring of weak banks, the Government of India should also consider setting up of a similar body. This may be called the Financial Restructuring Authority (FRA). Its main objective would be to co-ordinate and monitor the progress of the programme. It will represent the owner, in this case the Government of India and, vested with due authority from the government, it would be able to give the banks undergoing restructuring, guidance and instructions for proper implementation of the programme including course corrections wherever necessary. This authority will have to work in close co-ordination with the Banking Division, Ministry of Finance, which presently controls the public sector banks. While the basic control of banks covered by the restructuring will continue to be with the Ministry and there will be no change in the Reserve Bank of India's role of regulation and supervision, the FRA will monitor the progress of the programme and will have the powers to take all decisions relating thereto which the owner needs to take. In this regard, it will be an arm of the government. Its role and functions would need to extend over the policy as well as operational aspects of the restructuring programme and may include, *inter alia*, the following.

i. approving bank specific restructuring programmes,
ii. entering into agreements with individual banks covering the terms and conditions of the programmes and following up its progress with the bank and other concerned agencies. The need for such an agreement has been discussed in paragraphs 7.26 and 7.140

above,
iii. acting as an owner of the Asset Reconstruction Fund on behalf of the government and ensuring its proper governance,
iv. owning and/or participating in other Asset Reconstruction Funds/ Asset Reconstruction Companies that may be set up subsequently, and
v. arranging for the management of these funds by appointing Asset Management Companies.

The structure of the proposed NPA transfer mechanism, presented in a chart form, is given in Annex 15.

7.147 The Group is of the view that it would be desirable to set up such an authority under an Act of the Parliament so that with the force of law behind it the FRA enjoys a distinct individuality. Such force and distinction are considered necessary for any entity that will perform the kind of tasks it will be entrusted with.

7.148 The existing legal and institutional framework is defaulter-friendly and has been one of the biggest hindrances in recovering loans. In the absence of a special enactment for the FRA as proposed above, it will find it very difficult to succeed because the loans transferred to its ARF will mostly be chronic non- performing loans where the banks' efforts have already failed. The borrower having succeeded in frustrating the recovery efforts of the bank will be emboldened to continue frustrating the FRA as well. Conditions, therefore, need to be created so that borrowers do not find it advantageous anymore to frustrate the ARF's efforts at recovering its dues.

7.149 There have been earlier occasions when, by specific enactment, special powers/rights for recovering loans and/or dealing with collaterals relating thereto have been given, e.g., in the case of State Financial Corporations and the erstwhile Industrial Reconstruction Bank of India now operating as the Industrial Investment Bank of India (IIBI). Adopting a similar approach in the case of FRA, it may be established under a special Act of the Parliament with provisions protecting it against avoidable obstructive litigation and also from the necessity of legal procedures in enforcement of mortgages and other contractual rights.

7.150 The FRA is not being conceived as a permanent body as it is expected that, with the completion of the restructuring process of the weak banks, it would have outlived the utility of its existence and would be wound up with the winding up of the ARF it will own. Its existence may, however, have to be continued if in the meantime, some other bank or banks become weak and their restructuring is entrusted to its care.

Regulation and supervision of weak banks

7.151 Regulation and supervision of all banks is at present with Reserve Bank of India and receives the same kind of attention as received by all other banks. In view of the special problems faced by these banks and in order to ensure that their condition receives a more urgent and focused attention of the regulator, it is considered desirable that special arrangements be made for tracking their performance and regulatory compliance. The success of the FRA in carrying through the restructuring programme would depend largely on the quality and level of coordination it is able to achieve with the regulator on the one hand and the government on the other. It will, therefore, facilitate the process substantially and help effective implementation of the restructuring programme if within Reserve Bank of India, a

special wing is formed for regulating and supervising weak banks. On a number of issues like deposit insurance, regulation of subsidiaries, risk management, disclosures and regulatory compliance, the treatment of weak banks would need to be different from those of much stronger normal banks. A more focused regulation and supervision will facilitate weak banks' early restoration to health. This arrangement would also help early detection of and attention towards weaknesses emerging in other banks preempting a system-wide spread of these problems.

Improvement in the legal framework

7.152 The legal framework within which banks have to operate and particularly manage the recovery of their dues from the borrowers is far from adequate. For understandable reasons, many legal provisions have, in fact, a positive bias favouring the debtor who has traditionally been seen as weak and, therefore, in need of protection. Unfortunately, these very well intentioned provisions and the immense load and backlog of cases with the courts are making lending a hazardous option for the banks. Prolonged litigation prompted by legal lacunae in different commercial enactments is one of the main reasons for the increase in the size of the banks' NPAs. Some of these enactments are several decades old and, in quite a few cases, out of line with the present day realities. These provisions need to be amended urgently and some new enactments are called for in order to cater to the requirements of the changed and far more complex current economic and business environment.

7.153 Financial systems in other Asian countries too have suffered from similar handicaps. Many of them, however, have changed/amended their outdated and inadequate laws as part of the country's financial system restructuring. Thus, for example, within a short span Thailand has achieved an almost total revamp of laws relating to commercial transactions. Bankruptcy law has been modelled along the lines of provisions contained in various chapters of Title 11 of the U.S. Code in the United States and further changes therein are being enacted. Changes to laws on foreclosure and court procedures are also being enacted to ensure speedier enforcement of lender's claims. Specialised bankruptcy courts are also being set up. These are necessary for any exercise aimed at facilitating recovery of banks' dues and reduction of their NPAs. Similarly, effective changes in the legal framework in Malaysia have been made preventing the borrowers from making use of the legal process to delay creditors' action against them. It is noteworthy that special steps have been taken there to plug loopholes that previously allowed borrowers to contract additional debts or dispose of their assets while restructuring schemes were being worked out.

7.154 It would be necessary that changes along similar lines are made in our laws so that it can be ensured that the banks are not handicapped in their efforts of recovering dues from the borrowers. It is also important to note that without proper legal backing, the ARF also will suffer similar handicaps. Above everything else, it would be impossible to develop a secondary market in loans unless the necessary legal provisions facilitating hassle-free transfer of loans and recovery of dues are in place.

The working of Debt Recovery Tribunals

7.155 With a view to expediting recovery of dues through the legal process, Debt Recovery Tribunals (DRT) have been established under the Recovery of Debts Due to Banks and Financial Institutions Act, 1993. However, for many reasons, the DRTs have so far helped the recovery process of the banks only in a limited manner. The Group is aware that measures for strengthening DRTs have been examined by the Reserve Bank of India in the light of the

recommendations made by CBSR. The recommendations made in August 1998 by a Working Group set up in this regard address structural aspects of the functioning of DRT as well as the legal lacunae observed in the Act. The present Group understands that, in the light thereof, a Bill to amend the above Act has been introduced in the Parliament.

7.156 The Group also understands that the entire legal framework for effecting recovery of bank dues is being examined by an expert Group constituted by the Government of India under the chairmanship of Shri T. R. Andhyarujina, former Solicitor General of India. The expert group would also address the lacunae observed in the functioning of the DRTs and suggest amendments required therein. The present Working Group is of the view that till the necessary amendments to the Recovery of Debts Due to Banks and Financial Institutions Act, 1993, are made, steps should be taken to remove the administrative and infrastructural problems relating to the DRTs to improve and facilitate their effective functioning. The Group also considers it desirable that insofar as the recovery process of weak banks and the ARF is concerned, an arrangement may be worked out for the DRTs to attend to their cases on a priority basis. Towards this end, at least at some select centres, setting up of special benches of DRTs to assist weak banks and the ARF could be considered to give the restructuring process the much desired push.

Issues relating to vigilance

7.157 In the course of its deliberations, the Group received representations from the managements and the unions of the banks alike complaining of a sense of diffidence in taking credit decisions with which the banks are beset at present. Reportedly, this is due to investigations by outside agencies on the accountability of staff in respect of some of the NPAs. The Group also noticed a marked reluctance at various levels to take any credit decision. It has already been referred in an earlier chapter, how decisions are being deferred on compromise proposals in respect of NPAs. The banks, consequently, carry a heavy load of provisioning requirements and other attendant losses which they can ill afford. The Group is concerned that restructuring strategies which of necessity assume certain minimum levels of growth would not succeed if such a mindset persists.

7.158 The Group notes the recent initiatives taken by the CVC to include in the Vigilance Manual a separate chapter relating to vigilance in banks. Provisions contained therein address some long-standing concerns of the banks. In this context, the Group would like to recommend that the investigations into accountability both at the bank and at the level of non-bank agencies if completed in a time bound manner would go a long way in ending uncertainties and help in the overall improvement of morale of the staff. A time bound approach in these matters is absolutely necessary for creating appropriate conditions in banks in general and in weak banks in particular for future business growth and turnaround within a short timeframe.

Concluding remarks

7.159 Indian Bank, UCO Bank and United Bank of India, although weak are, in the opinion of the Working Group, still revivable if urgent steps are taken to initiate and implement a comprehensive operational, organisational and financial restructuring programme, provided it receives consensual support of all the stakeholders. The cost of restructuring, estimated at about Rs. 5,500 crore, to be incurred over the next three years, though high is considered the unavoidable minimum and, therefore, acceptable. Nearly two-thirds of this amount, i.e., approximately Rs. 4,000 crore, can be in the form of bonds issued/guaranteed by the

Government of India and will not have any immediate or direct impact on the government's budget excepting to the extent needed for interest servicing of the bonds. How much of this part of the restructuring cost finally ends up as an outgo for the government will depend upon the recoveries made by the ARF against the NPAs purchased from the banks and the improvements that result from the restructuring exercise in the profitability of the three banks.

7.160 The important point to note is that the restructuring programme will have to encompass operational, financial and systemic restructuring and must be implemented in a time bound manner. Any delay will add to the cost of the restructuring. In this context, it needs to be kept in view that the different measures suggested by the Group for operational, financial and systemic restructuring are a unified package and have to be implemented as such for the desired results to be achieved. Also, a stage has now reached when gradualism will not succeed and, in fact, if resorted to may cause more harm than good. By adopting a pick and choose approach, not only the total effect expected from the package will be lost, but even the individual measures picked up for implementation would lose much of their efficacy.

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[10] Reserve Bank of India (1997).
[11] Tarapore (1998).
1 [2] Garcia (1997).