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Past Efforts at Restructuring

Reserve Bank of India

Chapter 5

Past efforts at restructuring

5.1 As stipulated by the Reserve Bank of India, banks were required to attain capital adequacy ratio of 8 per cent by 31 March 1996. Since quite a few public sector banks were not fulfilling this requirement, Government of India had to infuse fresh capital in all the 19 nationalised banks. Under this programme, the government infused as capital Rs. 6,400 crore in 1993-94 and a further Rs. 4,362 crore in 1994-95. The capital infusion was through issuance of bonds carrying fixed coupon rates initially at the rate of 7.75 per cent per annum which, in subsequent issues, was raised to 10 per cent. Besides this, under the project sponsored by the World Bank for capital restructuring, the government availed of US$ 150 million as retroactive finance and provided these funds to six public sector banks by way of subordinated debt for their modernisation initiatives. In all, the Government of India has so far spent Rs. 20,446 crore on recapitalisation of the nationalised banks.

5.2 In order to prescribe some conditionalities for the assistance extended, the government desired that RBI may finalise a set of performance obligations and commitments in consultation with the CMDs of the banks to be fulfilled by them. The first such exercise was undertaken in 1992-93. Targets of performance were set for being achieved by the banks receiving assistance during the year. These targets/undertakings were contained in Memoranda of Understanding (MOU) entered into by the banks with RBI. The banks' performance, vis-à-vis targets, was reviewed at the end of the year to assess performance and to identify the reasons for shortfall, if any. The exercise initially covered all the nationalised banks which received capital infusion. Subsequently, as the performance of some of these banks improved substantially and the government's share in their equity started coming down due to public issues of equity made, a few banks were taken out of the purview of the MOU arrangement.

5.3 In the year 1997-98, the government decided to grant autonomy in respect of a few staff-related issues and branch expansion to those banks which had attained certain benchmark levels. These were capital adequacy of more than 8 per cent, minimum owned funds of Rs. 100 crore, uninterrupted record of profit for the immediately preceding three years and net NPA levels below 9 per cent. The banks eligible for autonomy were also excluded from the MOU exercise, which is presently confined only to seven banks. Indian Bank, UCO Bank and United Bank of India are additionally covered by bank-specific Strategic Revival Plans (SRP).

5.4 The Working Group observed that the MOU exercise had only a limited success in improving the financials of the weak banks. Linked with capital infusion by the government, the MOU exercise was aimed at rectifying the shortcomings of concerned banks so that they could reduce their losses and improve profitability. It has also been observed that in order to improve the conditions at these banks at a faster pace they were mostly given performance targets which were quite high and by their standards rather stretched. In most cases, therefore, these targets were not met. While less arduous obligations relating to deposit mobilisation, housekeeping, improving investment yield, etc., were often fulfilled, in more critical areas of performance such as expansion and diversification of credit, reduction of NPAs, prevention of slippage in NPAs, improvement in net interest margins, and reduction of costs, etc., the success achieved by the banks was very limited. Although such failures to achieve agreed targets or to fulfil commitments were frequent, there never were any penalties for such failures. Banks reporting operating losses were, no doubt, barred from opening new branches, recruitment of staff and fresh capital expenditure without RBI approval, but these restrictions did not serve as a disciplining measure as, in any case, they were already overstaffed and were in no position to undertake branch expansion or to incur any major capital expenditure.

5.5 The Group also observed that one of the reasons for the MOU exercise not succeeding was the manner in which it was conducted. The exercise for a particular bank normally began some time in June/July after the audited balance sheets were available. It took till about October/November to arrive at the understanding with the result that the remaining five months of the year were hardly sufficient to reach the agreed targets/commitments. In the short period left to them in the financial year for which the targets were agreed, the banks had hardly any time to develop an effective plan and to put them in action. In fact, the banks hardly if ever showed any strong commitment to the MOU with the result that it could never serve the purpose for which it was conceived, namely, removing the basic weakness of these banks. The government, however, continued to provide them with the required capital to meet the needs for their capital adequacy notwithstanding the continuous failures of these banks to meet their commitments in regard to their performance.

5.6 After the initial round of MOU exercise, four out of the eight nationalised banks which incurred operating losses in 1992-93 (viz., UCO Bank, United Bank of India, Bank of Maharashtra and Central Bank of India) were identified for specific restructuring efforts. In September 1994, RBI in consultation with the Government of India appointed consultants for the banks as indicated below:

1.	Bank of Maharashtra	Shri W.S. Tambe, former ED, RBI, in consultation with NIBM
2.	Central Bank of India	KPMG Peat Marwick
3.	UCO Bank	ICRA Ltd.
4.	United Bank of India	ICRA Ltd.

Indian Bank was added to the list after it incurred huge losses in 1995-96 and ICRA was appointed in 1996 as consultants with RBI concurrence, for conducting a diagnostic study of the bank and suggesting measures for its revival.

Restructuring efforts

5.7 The consultants were mandated, *inter alia*, to formulate strategies for the five banks mainly in respect of the following:

a. Reduction of non-performing assets.
b. Increasing income and reduction of costs.

c. Rationalisation of staffing pattern and branch structure.
d. Exploration of the possibility of a limited asset reconstruction fund.
e. Product analysis and product delivery.
f . Information system and business projections.

5.8 The consultants studied the working of the banks and some of the major deficiencies in the banks as observed by them were as under:

a. Comparatively lower resource base and lower volume of business (fund and non-fund based) resulting in lower income generation.

b. High proportion of NPAs and high rate of NPA generation.

c. Increasing administrative expenses not commensurate with the level of business and income.

d. Overstaffing (estimated at around 20 per cent in UCO Bank and UBI).

e. Absence of strategic planning, MIS, risk management and internal controls.

f . Unremunerative operations of overseas branches and subsidiaries.

5.9 Based on the diagnostic studies, the following measures towards restructuring the banks were recommended by the consultants:

a. Massive capital infusion (UCO Bank – Rs. 375 crore, United Bank of India – Rs. 550 crore, Indian Bank – Rs. 2,150 crore, Bank of Maharashtra – Rs.150 crore).

b. Total management of NPAs through

   (i) Setting up of ARF for taking over NPA accounts aggregating Rs. 808 crore, Rs. 281 crore and Rs. 313 crore from Indian Bank, UCO Bank and United Bank of India respectively, and

   (ii) Recovery of NPAs through judiciously negotiated compromise, settlement and invocation of government guarantees.

c. Cost reduction through wage freeze and downsizing through VRS (UCO Bank, United Bank of India and Central Bank of India).

d. Improving the business through deposit growth to bring it on par with that of leading banks and better credit delivery through revamping of credit appraisal systems.

e. The consultants also recommended splitting the CMD’s post into that of a non-executive Chairman and a Managing Director, addressing the problem of inadequate senior management due to serious gaps in succession (in UCO

Bank and UBI), cost reduction and business improvement through winding up of overseas operation of UCO Bank and Indian Bank, improved customer service, housekeeping, rationalisation of branches, redeployment of excess manpower in deficit areas, recruiting professionals in merchant banking, MIS and strategic planning, etc., and setting up of Asset Liability Management Committee (ALCO) (Indian Bank).

5.10 Based on the recommendations of the consultants, the banks initiated measures for improving deposit mobilisation, recovery of NPAs, toning up of credit management system, improving housekeeping, etc. However, there were reservations on the strategy suggested on wage freeze, VRS and closure of overseas branches. Setting up of an ARF was not found to be feasible by the GOI/RBI.

5.11 Consequent to the attempts made from within, two out of the five banks, Bank of Maharashtra and Central Bank of India, improved their levels of performance. During 1995-96, Bank of Maharashtra posted a net profit of Rs.12.60 crore helped by an increase in its interest spread to working funds from 2.92 per cent to 3.83 per cent and a growth rate of 28 per cent in other income. The bank's gross NPAs declined from 25.7 per cent of gross advances to 21.9 per cent during the period. The bank continued to show profits thereafter. Central Bank of India came out of the red in 1996-97 with a net profit of Rs. 150.83 crore. The bank's interest spread to working funds increased from 2.65 per cent in 1994-95 to 3.21 per cent in 1996-97. In view of the above, it was decided to confine the exercise of monitoring the progress under revival strategies only to the other three banks, viz., Indian Bank, UCO Bank and United Bank of India.

Strategic Revival Plan

5.12 At the instance of the then Finance Minister, these banks drew up Strategic Revival Plans (SRPs) for their turnaround. The restructuring plans drawn to remove the weaknesses identified by the consultants aimed at achieving profitability targets in definitive timeframes through improvement in key performance areas such as mobilisation of low cost deposits, reduction of high cost CDs, improving credit management system to ensure containment of NPA generation and recovery of NPAs, improving housekeeping and toning up of MIS, etc. The staff unions of the weak banks also signed an MOU assuring higher productivity and removal of restrictive practices. Indian Bank and UCO Bank also constituted Committees of Directors to monitor the progress made under their SRPs.

Implementation of SRPs

5.13 The banks did adopt the revival plans but the extent of success achieved thereunder is far from significant. Certain measures such as setting up of ALCO at Head Office, Settlement Advisory Committees and recovery cells for recovery of NPAs were implemented. However, the banks were unable to achieve the important objectives of earning profit and reducing losses by 1998-99. All the banks reported operating losses in 1996-97 and barring UBI which could manage net profit during

1997-98 (due to receipt of an unusual income of Rs. 111 crore by way of interest on Income Tax refund), the other two reported losses. Indian Bank continued to incur operating loss in 1998-99 as well. Despite their dismal record, the Government of India infused capital of Rs. 2,100 crore in 1997-98 and Rs. 400 crore in 1998-99 in these banks to shore up their CAR.

5.14 As briefly stated above, performance of the three banks under the SRPs was not satisfactory. The banks were aware that non-fulfilment of the obligations would not lead to any adverse impact on their overall continuance. The MOUs with the Unions also had only a limited impact on cost reduction as the 'sacrifices' made were only peripheral such as reduction in overtime and certain other allowances. The other measures of cost control such as rationalisation of a few existing branches, embargo on new branches, curtailment of major capital expenditure, etc., did not have any major impact and the cost income ratio of UCO Bank and United Bank of India continued to exceed 90 per cent, and that of Indian Bank 140 per cent, even by March 1999. The only significant result has been the closure by UCO Bank of its London branch and merger of its two branches in Singapore.

5.15 In a belated recognition of the need for action, the committee of the Board of UCO Bank set up to monitor progress under revival plan had recommended (i) downsizing of the staff strength through VRS (7,000 staff to be reduced in a phased manner in three years), (ii) further capital infusion of Rs. 250 crore by the government, (iii) mobilisation of Tier II capital, (iv) Non-implementation of wage settlement, and (v) closure/merger of loss making branches. The recommendations have not been supported by the representatives of the staff. There have been no serious follow-up measures to implement the recommendations.

5.16 To sum up, the restructuring efforts initiated so far have not had the desired impact. The hard options have been avoided and the steps taken so far have had the clear objective of maintaining the capital adequacy ratio of the banks with the assistance of Government of India so as to remain afloat. The banks have failed to develop the required resilience or strength to become competitive in the true sense. The past restructuring attempts were thus feeble and could be deemed as holding on operations without the perspective of improving the banks' long term viability and competitive efficiency.