CHAPTER 10

SUMMARY OF MAIN FINDINGS AND SUGGESTIONS

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Section I

Main Findings

The main hypothesis tested was as under :

C M E = F (PE, AE, RE, TE, DE) and the sub hypotheses laid down were :

(i) $PE_1 = a_1 X_1$

(ii) $PE_2 = -a_2 X_2$

(iii) $PE_3 = a_3 X_3$

(iv) $PE_4 = -a_4 X_4$

(v) $PE_5 = a_5 X_5$

(vi) $PE_6 = -a_6 X_6$

(vii) $PE_7 = -a_7 X_7$

When the sub-hypotheses were tested, on the basis of the available data it was found that :

(i) $PE_1 = -0.4772910^{-1} X_1$

(ii) $PE_2 = -0.2401110^{-1} X_2$

(iii) $PE_3 = 0.52736 X_3$

(iv) $PE_4 = -0.22909 X_4$

(v) $PE_5 = -0.7707810^{-1} X_5$

In other words, on testing the sub-hypotheses, it was found that the Interest and Discount as percentage to working Funds, X_1 , and the Profit Efficiency, PE, are negatively (negligible) correlated. This does not sustain our sub-hypothesis which stated the inverse. This was explained by the multicolinearity which was observed between X_1 and X_2.

The sub-hypotheses , according to which the Interest paid on deposits and borrowings affects negatively the Profit Efficiency of bank was substained. This is the coefficient of correlation between X_2 and PE_2 . Here also, due to the multicolinearity between X_1 and X_2 the desired result was not obtained.

The Profit - Earning ratio, X_3, affects positively the Profit Efficiency. It was found that , if the Profit - Earning ratio increases by say, 100, the Profit Efficiency (or Return on Working Funds) increases by 53 . Therefore our sub-hypothesis(iii) was substained.

The priority Sectors' advances, X_4 , affects negatively the profitability of banks. It was found that, for every Rs.100 lent to the priority sectors, the profitability of banks decreases by Rs. 23. This illustrates well the conflict between profitability and the social objectives. Here also our sub-hypothesis (iv) was substained.

It was also noted that the maximum utilisation of resources does not mean necessarily maximum Return on Working Funds. That is why our sub-hypothesis (v) was not sustained.

In the absence of data pertaining to the ratio Amount Outstanding in sick units as percentage to total bank credit and the non-recovery ratio for each commercial bank, the sub-hypothesis (vi) and (vii) could not be tested.

From the test of the sub-hypotheses, it resulted that among the set of the selected ratios, only the ratio Profit Margin/Earnings X_3, was the most determinant of Profit Efficiency and the equation arrived at was :

$$PE = 0.08\ X_3$$

To draw the profitability list, banks were ranked on the basis of the Return on Working Funds (PE). The most efficient banks in 1981 in terms of Profit Efficiency were the Andhra Bank, the Corporation Bank, the Indian Overseas Bank, the Canara Bank and the Bank of Baroda to name only five of them.

It was observed that except the State Bank of India which occupied 15th position in that Profit Efficiency list, almost all its seven associates were the last ones in the same list.

To be efficient in managing their credit, Banks should not only make profit but fulfil their social responsibilities in financing the priority sectors. The Advances Efficiency equation arrived at was $AE = .4\ X_4$ and on the basis of it banks have been ranked in terms of Advances Efficiency.

The most efficient banks in 1981 in terms of Advances Efficiency were the State Bank of Patiala,

the State Bank of Hyderabad, the State Bank of Travancore, the Punjab and Sind Bank, the Andhra Bank and the Corporation Bank, to name only six of them.

The results pertaining to the Advances Efficiency when compared to those pertaining to the Profit Efficiency showed interesting results.

The Andhra Bank which was the most profitable bank occupied the 6th position in financing the priority sectors and the following 3 others in the same profitability list occupied respectively 7th, 9th and 20th positions. Therefore, it is established that the more a bank finances the priority sectors, the less is its profitability. This illustrates well the conflict between profitability and the social objectives.

However, it was not reported anywhere that a bank has sustained a loss because of its assistance to the priority sectors. The cases of Andhra Bank and the Corporation Bank which are respectively first and second in the profitability list and which fulfil the target laid down for the Priority Sectors, show very well that a commercial bank can fulfil its social responsibilities and still be profitable.

In the absence of data pertaining to the Recovery Efficiency, the Time Efficiency and the Disbursement Efficiency, it was difficult to draw a conclusion for these three components of Credit Management Efficiency. But it has been proved upto a great extent that C M E = F (PE, AE, RE, TE, DE).

Further, we had also to prove that :

ICME = IPE + IAE + IRE + ITE + IDE

For the same reason as mentioned above, only the IPE and the IAE have been taken into consideration in the illustration of the ICME.

A cut-off point was worked out for the Profit Efficiency and the Advances Efficiency so as to determine the IPE and the IAE.

The Profit Efficiency equation being PE = 0.08 X_3 and the mean value of X_3 being 1.2718, then the cut-off point for the Profit Efficiency is 0.10 (i.e. 0.08 x 1.2718). On the basis of this cut-off point, an IPE has been determined.

Index of Profit Efficiency

If Profit Efficiency is		Then give the Mark
More than or equal to	0.10	1
Less than	0.10	-1

The Cut-off point retained for the Advance Efficiency was 40 % , the stipulated target for the priority sectors.

Index of Advances Efficiency

If Advances Efficiency is		Then give the Mark
More than	40	0.5
Equal to	40	1
Less than	40	-1

Therefore, the I C M E was developed only on the basis of the I P E and the I A E . It is summarised as below :

Index of Credit Management Efficiency

I P E	I A E	I C M E
-1	-1	-2
-1	0.5	-0.5
1	-1	0
1	0.5	1.5
1	1	2

On the basis of the I C M E , banks were classified into five groups. The first group was constituted by those which had the highest I C M E i . e. 2, the second group those with an I C M E of 1.5, the third group with 0, the fourth with -0.5 and the fifth group with an I C M E of -2.

The first group of banks, with an I C M E of 2 were those banks, which made reasonable Profit (within or above the cut-point of Profit Efficiency) and were fulfilling the requirements of the priority sectors. This was the case of the Andhra Bank, the Corporation Bank, the Bank of Baroda and the Bank of India. Therefore, the standard I C M E was found to be 2.

The second group with an I C M E of 1.5 were those banks which made a reasonable profit but over-financed the priority sectors. To improve their I C M E , they should decrease their assistance

to the priority sectors and divert the surplus to the traditional sectors in order to increase their profitability. This was the case of the Dena Bank.

The third group with an I C M E of 0 were those banks which made a reasonable profit but were under-financing the priority sectors. To improve their I C M E, they should increase their share to the priority sectors. This was the case of the Indian Overseas Bank, the Canara Bank, the Union Bank of India etc.

The fourth group with an I C M E of -0.5 were those banks which were below the average Profit Efficiency but were over - financing the priority sectors. To improve their I C M E, they should decrease their share to the priority sectors and divert the surplus to the traditional sectors in order to earn more. This was the case the State Bank of Hyderabad, the Punjab and Sind Bank etc.

The fifth group with an I C M E of -2 were those banks which were below the average Profit Efficiency and were under-financing the priority sectors. This was the case of the State Bank of Bikaner and Jaipur, the Vijaya Bank, etc. The management of these Banks, should find out the factors responsible for this poor performance. They have to increase first their Profit Efficiency and secondly achieve the target of 40 % for the priority sectors.

In the area of delegation of powers in commercial banks, it was suggested that the existing system of delegation of sanctioning/renewing the proposals should be again deconcentralised at the Head Office as well as at the zonal, regional and branch offices in order to avoid long delays in sanctioning the proposals.

In actual practice where bank frauds are very common and particularly in the area of lending, the power of sanctioning a proposal and renewing it should not be carried out by the same official.

For the priority sectors, it was felt that bankers should right now divide the sanctioning powers into two parts. One for the traditional sectors and the other for the priority sectors. This will help the borrowers from these sectors to get their projects sanctioned in time.

It was recommended that, in order to avoid the political interferences in the banks' decisions, non politicians bank officers be appointed at the top level.

As the regional offices are near to the operation scene, more sanctioning powers should be given to them to avoid delays in decisions.

For the techniques for appraising working capital as suggested by the Tandon and Chore Working groups, it was suggested that the actual norms, which are the main key to the new techniques, should be again re-examined in order to see if they still hold good because they are dated since more than a decade.

In monitoring bank credit, commercial banks face again many problems. The recovery of bank credit was found to be very poor. Many banks and particularly those operating in agriculture recover just half of their advances. Both the banker and the borrowers are responsible for the poor recovery of advances.

From now, borrowers should know that the bank credit is not a gift and therefore is to be repaid. Bankers were advised to reinforce their system of follow-up and supervision of bank credit without pressing the borrowers to repay the credit before the date it was supposed to be paid. In recovering advances, there should not be any political pressure on the bankers to prevent them from taking legal actions.

In order to prevent industrial sickness, banks were advised to reinforce their system of credit monitoring and to use the techniques of Multiple Discriminant Analysis applied to financial ratios to prevent industrial sickness.

It was also suggested that the existing system of rehabilitation and nursing of sick units should be improved and a new approach towards industrial sickness introduced.

Right from now, at all their organisational levels, commercial banks have to comprehend that sickness of industrial units has distinctive stages and it is feasible for them to identify sickness at its early stage. If they assume their responsibilities efficiently, they can do much better to ensure the health of their borrowers.

In order to fulfil this objective, commercial banks were given the following recommendations.

Firstly, they should rarely attempt the nursing of sick units all by themselves. Right from now, they should coordinate with term lending institutions in the rehabilitation of the potentially viable units.

Secondly, instead of rehabilitating several units and make then less sick, they should select only those which are really potentially viable.

Thirdly, the existing organisation and management information system would also have to be re-examined in order to make necessary improvements to facilitate smooth and successful functioning of the system. This implies the redefinition of the bankers - borrowers relationship and widen the role of branch, zonal, regional and Head Offices in Credit management.

Fourthly, commercial banks should classify their industrial accounts above a cut-off point (say above a credit limit of Rs. 10 lakhs) on a five point - scale, ranking from healthy to chronically sick, the intermediate stages being tending towards sickness, incipient sickness and sick, using the concept of Multiple Discriminant Analysis applied to financial ratios. This exercise will help the bankers to follow the evolution of the units financed by them and consequently identify those accounts whose health is poor.

Fifthly, commercial banks should be provided

with such a regulation that in certain cases as soon as the current ratio is less than one and the debt equity ratio worsening to call back their money.

Lastly, commercial banks should call for penalising the management responsible for making an industrial unit sick by siphoning off its funds.

In the monitoring system, bankers are treating a lot of data manually and as a consequence to revive a sick unit timely decision is not taken due to the fact that the manager is not getting the information in time. In order to overcome these problems, the introduction of the Electronic Data Processing (EDP) was suggested at the stage of credit monitoring.

The E D P will help the manager to get the data in time, to improve the control function of the higher authority, to increase the productivity of bankers, and to detect sickness at an early stage.

Even introduced in Banks, the E D P will not be enough. It will help bankers to increase their productivity and their performance in credit management but it will not measure this performance. That is why in the new system of credit management proposed, the EDP should go alongwith the construction of an Index of Credit Management Efficiency and an implementation by commercial banks of the suggestions offered in this study.

Section III

Recommendations for further studies

For further studies relating to the Index of

Credit Management Efficiency, the data pertaining to the amount outstanding in sick units, the amount of bank credit non-recovered, the time between sanction and disbursement of proposals, and the utilisation of sanctioned limits by borrowers should be obtained for each bank and integrated in the final I C M E Model.

Also time series data should be used because the efficiency of cross section data is very limited, particularly for Regression Analysis.

Never has credit management been so challenging than what it is today !