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# Urban Cooperative Banks: A Case Study of Karnataka

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Indian society today mirrors an inequality that maybe summed as an envelope of darkness intensifying around the light. Looking to the urban areas, we see the co-existence of immense prosperity and widespread poverty.

The Urban Cooperative Banks catering to the needs of the people of the weaker sections in the urban areas are a powerful means of financial empowerment and financial inclusion. Urban Cooperative Banking is based on the twin model of Banking & Cooperation. In spite of immense heterogeneity in assets, operation area, nature of operation; UCBs have immense potential to tackle externalities that inhibit smooth credit flow at a local level.

In 2003, with RBI's liberal licensing policy, there were 1,941 UCBs and their deposits and advances were to the tune of Rs. 1, 01,546 crore and Rs. 64,880 crore respectively. Licensing of new UCBs was banned from 2004 and consolidation was encouraged. This together with the chain effect of a major UCB scam has resulted in a decline in the number of UCBs. As on March 2009, there were 1,721 Urban Cooperative Banks with 1,58,733 crores worth deposits, of which 53 were Scheduled commercial banks.

UCBs are grappling with the threat of ever increasing Non-Performing Assets and dismal finances and suffering from certain incessant weaknesses as unsound governance, unethical lending, and high level of loan defaults. The Reserve Bank of India is considering their mergers with the public sector banks as despite poor performance, these banks forward the targets for Financial Inclusion. In this light, it is an imperative to assess and remedy their situation, as in an era of intense competition UCBs must explore new ways of increasing incomes and survive to keep supporting the poor or semi-poor urban populace.

A recent 'Working Group on Umbrella Organization and Constitution of Revival Fund for Urban Cooperative' of the RBI was formed in 2008. It recommends the formation of an Umbrella organization to provide the services of fund management, investment banking, management consultancy, ATM networks, capacity building services etc. An emergency Fund Facility Scheme and a Revival Fund has also been put forth.

I have undertaken a Case Study on UCBs in Karnataka. It is based on first-hand qualitative and quantitative data from the UCBs, secondary data from RBI Offsite Surveillance System, Bank's Balance Sheets & RBI Inspection reports. A survey of the selected UCBs in June 2009 yielded meaningful insights.

A questionnaire was designed based on the Central Bank guidelines and the Memorandum of Understanding for UCBs. Previous findings in available literature and the aspects of capital adequacy, asset quality, liquidity, management, and earnings were assessed. Based on the study, recommendations are made on the future and scope for the UCBs.

8 UCBs in Bangalore City were selected for the purpose of study. Profitability in terms of Returns on Assets (ROA) rose for 5 out of 8 banks with the highest growth of 3.7%. However, it has risen only by a very small percentage which indicates that the banks should attempt to make better use of available funds. Operating Efficiency had fallen for 5 out of 8 banks. Cost of funds fell for 6 out of 8 banks and Return on Equity fell for 7 out of 8 banks.

Thus profitability had fallen in terms of ability of the banks to generate adequate returns. The Banks should therefore attempt to improve returns. It can be concluded that for the banks chosen as a case study in Bangalore, performance in terms of Returns on Assets & Returns on Equity has been far from satisfactory. On the other hand progress in terms of reduction in cost of funds has been good but efficiency in operation was low. Thus, the banks must attempt efforts to improve profitability by corrective steps.

A particular Grade-1 UCB, Mahila Co-op bank in Karnataka, from its very inception catered to women of weaker sections of society and took rapid strides in terms of profitability. Its Profits rose by 8% from 2003-2007 with a high current rate of Returns on Assets at 1.92%. The bank attributed this progress to successful deployment of funds for loans, the progress in terms of recovery by constituting recovery teams that made daily visits. It had formulated various kinds of deposit schemes such as Recurring Deposit Schemes, Mahila Nidhi etc to suit its customers. A recent initiative was the Daily Deposit Scheme introduced in April-09 in order to further attract deposits. The Board consisted of 11 members including 2 professional directors which define policies for the bank. The future course of action of the bank was in terms of framing new deposits & loan schemes & be able to sustain & augment profitability further. This was the perfect case of a well functioning UCB. In general most Mahila Cooperative Banks were performing well in Karnataka. A Grade-2 Bank, Kalidasa Co-op had shown remarkable progress under RBI directives since 2005-06. Since then the bank made a turnaround with better recovery efforts & improved deployment of surplus funds. There is an increase in deployment of funds towards advances that earn more interest & investment portfolio has come down. Operating profits have shown an increase. The bank attributes its increase in profits to profitable use of surplus funds. Importance is given to NPA Recovery with setting up of Recovery teams & Recovery camps every week. Unproductive expenditures have been avoided & the bank is in a position to declare dividends. A Grade-3 bank, Anjaneya Co-op bank had accumulated losses to the tune of 117.43 Crores with a net NPA of 16%. The bank attributed this to poor recovery efforts. Verification & post-sanction supervision had not been up to the mark. The bank was as a result unsuccessful in attracting new depositors. In the future the bank expects to meet the losses over a period of 3 years. One of the Grade-4 banks, which does not wish to be named, was facing repercussions of an earlier fraud and was under huge losses as a result. However it had well-designed policies on all fronts in terms of deposit Mobilization Campaigns, loans & investments, training etc. This particular bank had the capability of becoming a grade 1 bank once it meets its losses. The proposed Umbrella Organization can facilitate the grade-3 and grade-4 banks in this direction in future.

In Mysore district in terms profits, from 2004 – 2008, the % growth was large & positive for most of the banks among the 10 UCBs. The performance of Mysore UCBs can be seen in Table 1. The highest % growth in profit was at 373% from 4 lakhs in 2005 to 19.3 lakhs in 2007. Assessed CRAR was 29.8%, much above the regulatory requirement of 9% as on March 2007. It has moved from a grade-3 (2005) to a grade-1 bank (2007) and continues as a grade-1 bank on account of net NPAs at 8%. Aggregating the profits of all the Mysore UCBs & observing them over time shows a continuous increase from 2004 to 2008. There been an increase of 80% in operating profits for all the 10 Mysore UCBs together.

As per March 2008 reports, for the 17 UCBs in Bijapur district, the profits rose by 218.66 %. The performance of Bijapur UCBs can be seen in Table 1. A Grade-3 bank is the most profitable bank with a gross profit of Rs 641.68 lakhs. It has moved from a grade-4 (June-04) to a grade-3 bank (Mar-07) and continues as a grade-3 bank on account of net NPAs above 15%. The Net Profit stood at Rs 155.33 lakhs on March 2008. Gross & Net NPAs were high & stood at 44.1% & 25.1 respectively. The Bank had been superseded by RCS Karnataka. With a net worth of Rs 2031.87 lakhs the bank had adequate assets to meet its liabilities as on March 2009. However the bank did not have adequate CRAR. The operating Profit rose by 95.2% from 2002-2008. Income fell by 28.9% from 2002-2008 and Expenditure also decreased by 94.3% .Thus, this bank has been performing well in spite of inadequate capital adequacy. Its Operating profits have risen by means of rising spread & falling expenses. It has thus moved from Grade – 4 to Grade-3.

**TABLE-1: PERFORMANCE OF MYSORE & BIJAPUR UCBs**

<b>MYSORE</b>				<b>BIJAPUR</b>			
<b>Year</b>	<b>Interest Incomes</b>	<b>Total Assets</b>	<b>Profits</b>	<b>Year</b>	<b>Interest Incomes</b>	<b>Total Assets</b>	<b>Profits</b>
<b>2004</b>	2806.52	27211	570.28	<b>2004</b>	6,332.74	51511.8	303.8
<b>2005</b>	2931.28	28068.8	635.849	<b>2005</b>	2,389.90	50613.6	209.67
<b>2006</b>	3036.01	30175.2	831.07	<b>2006</b>	5018.19	54562.1	288.41
<b>2007</b>	2977.31	33771.8	888.58	<b>2007</b>	5694.78	50377.4	317.74
<b>2008</b>	3772.82	39637.1	1026.58	<b>2008</b>	5882.02	54422.9	968.08
<b>%GROWTH</b>	<b>34.43</b>	<b>45.67</b>	<b>80.01</b>	<b>%GROWTH</b>	<b>-7.12</b>	<b>5.65</b>	<b>218.66</b>

Source - Compiled from OSS and Reports from RBI and UCBs.

Therefore, from the performance of the UCBs in Bangalore, Mysore and Bijapur in Karnataka we can reiterate the fact that an increasingly transforming socio-economic milieu and shifting socio-economic paradigms necessitate the Urban Cooperatives to become a constant innovator. Introduction of new schemes at attracting deposits had met with considerable success in the districts of Mysore and Bijapur. It was observed that a major reason for the good performance of the grade-1 & grade-2 banks in Karnataka was the profitable fund deployment & successful recovery efforts. It can be said that improving interest & non-interest incomes by exploring new business opportunities should be a constant endeavour for improving profits.

An Urban Cooperative Bank must strive to ensure financial stability. Sound Fund Deployment Strategies is the first & most essential step to maintain profits. Better & improved Recovery efforts to keep NPA levels under control and certain innovative schemes such as recovery camps are a fruitful step in this direction.

Operational Costs must be kept within limits by following budgeted policies & strict budget control. Efficient & personalized customer services and products suitable to local needs must be undertaken. Appropriate & affordable technology by assessing the in-house capabilities for provision of IT products & services should be combined with competent policies for recruitment & training of staff.

Issue of Demand Drafts & Telegraphic Transfers and remittance of funds through tie-ups with commercial banks may also be explored. Collection & Payment of Utility Bills like telephone, corporation taxes etc on behalf of customers are a good source of income & would generate goodwill. Insurance Business could be taken up on referral basis (not bear risk). Conduct of foreign exchange Business is allowed on fulfilment of certain conditions and can be a profitable proposition. RBI has now allowed UCBs that have signed MOUs & registered under Multi-State Co-operative Societies Act to enter into agreements with Mutual funds for marketing units. This may be undertaken by the bank to improve incomes.

Demat Services by applying to SEBI & fulfilment of certain criteria is a good opportunity for increasing incomes but the bank must possess the requisite expertise & technology. The costs & Benefits should be weighed in addition to increase in volume of transactions & break-even. Issue of Bank Guarantees & Letters of credit (intermediate between buyers & sellers) may also be used to earn incomes. Making lending rules more responsive to current profits and projections of future profits may be a way to both target better and guard against potential NPAs.

The future of UCBs is challenging yet worthy and depends on transparency in control and operation, governance, customer-centric policies, technology-upgradation and efficiency.

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