FINANCIAL INTERMEDIATION IN A LESS DEVELOPED ECONOMY

The History of the United Bank of India

Indrajit Mallick
Sugata Marjit

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To

Our Parents

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INTRODUCTION

This book is about the relationship of banking to economic development. In this introduction, we trace the outline of the theory of banking and the combined theory of banking and economic development. However, when we confront theory with institutional reality, we find that the theoretical framework is inadequate in many respects to answer some important institutional questions. While paying tribute to the abstractions entailed in the theory of banking and the theory of banking and economic development combined, we are convinced that our concern can be more satisfactorily met through a proper historical investigation rather than a purely theoretical enquiry. Therefore, we propose and identify a single but illuminating case study—the history of a banking institution in Bengal. We highlight the classical underdeveloped context of the economy of Bengal in the 19th and 20th century, put our questions in their proper historical context and offer some tentative answers. We motivate the importance of an institutional narrative to properly understand the institutional questions and categorize the different aspects of institutional dynamics that the book seeks to bring out, thus characterizing the relation between the process of institutional development of the financial intermediary and its relation with economic development.

The Theory of Banking and Financial Intermediation

Any work on financial intermediation has to address the following questions:

(*a*) What is the nature of banking and the characteristics of a financial intermediary?

(*b*) Why do we at all need a system with a financial intermediated structure instead of a purely institution-less financial market system?
(*c*) What is the relation between financial intermediation and economic growth and development?

These issues can, in principle, be dealt with a theory of banking and financial intermediation. In this section, we shall briefly introduce our readers to the theory of banking and financial intermediation. We shall cover those aspects that are most relevant, given the nature of our queries.

Theory defines what exactly we mean by a financial intermediary, why they exist and what (useful) role they play. Theory also seeks to understand what the tools for prudential regulation of banking should be and how they should be used. This also encompasses a theory of financial crises and preventive as well as curative prescriptions. Theory ideally allows us to address the issues on management, structure, ownership and regulation in banking and thus helps us formulate an institutional theory of banking. As we shall see, the existing theory of banking has characterized the existence and functioning of banks in a neat way, but has failed to evolve an institutional theory of banking which accounts for structural change in banking. We shall claim that our effort would be precisely to fill up this gap to a limited extent, but before we confront theory and the institutional reality of banking, we must first create a brief sketch of the operation of a banking firm around which theory and regulation can be built.

A financial intermediary is an organization that is a buyer and seller of securities. A commercial bank is a type of intermediary that typically sells securities called deposit contracts and buys securities called credit contracts.[1] Depositors want liquid, safe securities of small denominations. Firms want to sell illiquid and risky securities of large denominations. The financial intermediary must ensure that this mismatch is taken care of by suitable transformation of assets in its own balance sheet. This asset transformation role of the banks was highlighted by Gurley and Shaw (1960). A deposit contract specifies that the buyer can withdraw his deposits on demand or time basis. This insures the depositor against the liquidity uncertainty that he faces and, at the same time, reduces the transaction costs of not having money at any given point of time (Diamond and Dybvig 1983: 401–419). Thus, a commercial bank provides a liquidity insurance service to its depositors and absorbs this liquidity risk itself. A financial market under-provides such a liquidity service and is, in this respect, inferior to the financial intermediary. However, this liquidity arrangement by the financial intermediary can lead to situations where bank runs occur and the bank becomes insolvent or bankrupt. Economic theory distinguishes between two types of bank runs: one based on depositor panic without any change in fundamentals and another based on some adverse signal about the future of the bank. A bank also offers payment services allowing the deposit holder to write cheques against his deposits, for the purpose of making payments as well as clearing large transactions between merchants and firms. On the assets side, the loans are made to firms to buy equipment, maintain inventories, pay wages and bear other costs, thus converting savings into investment and working capital, and enabling the production machine of the economy to run smoothly. The existence of banks are primarily justified by the role they play in the process of resource allocation and more specifically in generating optimal savings as well as optimal capital allocation among alternative investment plans. In the process, the bank takes a risk by providing capital to the firm apart from the liquidity risk on the liability side. It turns out that in the context of a less developed country, this risk-taking role becomes even more significant. The ability of financial intermediaries to bear the credit risk will determine the path of economic growth and the standard of living. Some problems, of course, come in the way. Adverse selection and moral hazard, the two fundamental credit market problems stemming from the information asymmetry of the market, come into the picture. Adverse selection problem arises when among the group of potential borrowers, a certain proportion of borrowers are of the high risk type and at the time of screening for loan contracts, it is private information to the borrower as to which risk class he belongs to. Moral hazard arises when *ex ante*, that is, at the time of (loan) contracting, all borrowers are identically risky but after the contract is executed and loan disbursed, an individual borrower has opportunity to make non-observable risky investments which can lead to loan default. Loan defaults can also be strategic when renegotiation is the only way out for the bank. The presence of these problems would require different kinds of restrictions on contracts and incentives, and usually gets accompanied by credit rationing that constrains investment by firms. Banks' evaluation of a loan proposal, the collateral against which the loan is given, the loan covenants, post sanction monitoring and even the banks' indirect influence on management are measures designed to take care of the credit risks. In particular, monitoring by the financial intermediary is seen as a transaction cost minimizing mechanism, whereby duplicative and socially redundant monitoring by the individual depositors and investors would be obviated. Thus, the financial intermediary is seen as a delegated monitor. In this respect also, the financial intermediary is superior to a market allocation. Still a substantive part of risk remains unhedged. To compensate for the risk taking, the intermediary has to earn a proportionate rate of return. The performance of the banking sector affects the entire structure of the economy and requires careful prudential regulation and supervision. On the liabilities side, insuring deposits takes care of unnecessary banking panics but creates a moral hazard of excessive risk taking by banks and low effort in monitoring by depositors (this was precisely the case in the Savings and Loans crisis in USA). An inter-bank market for liquidity also serves to protect banking from the adverse effects of inefficient liquidity allocation in the banking system. Lender of last resort is another well known safety device for banks. But lender of last resort also creates the moral hazard problem of excessive risk taking by banks. Therefore, prudential supervision requires auditing of the bank balance sheet periodically and putting restrictions on assets and liabilities. Prudential regulation requires less than full deposit insurance and case by case execution of the lender of last resort policy.

In a frictionless contracting world of uncertain but well known distribution of state contingent payoffs, ideal risk sharing can be made possible through the state contingent payoff structure of financial securities. However, in reality, financial markets are beset by problems like transaction costs, adverse selection and moral hazard. When failures occur in financial markets due to problems like search, negotiations and enforceability, then financial institutions can resolve the issues better by minimizing transaction costs, by bringing transactions within the financial intermediary. When financial markets fail due to adverse selection or moral hazard, the main reason is that the marketed financial securities are not sufficient to screen borrowers and to prevent sub-optimal effort by the management of the firms. Financial intermediaries that design screening contracts in the presence of adverse selection problem or moral hazard are able to weed out inefficient risk taking, empire building by management, diversion of cash flow and defaults that lead to prolonged and costly debt recovery and bankruptcy litigation. Financial intermediaries also bring about a better allocation through avoiding the duplication of monitoring effort that is entailed in a market setting. Last, but not the least, financial institutions are better than financial markets in smoothing inter-temporal risks. Despite these factors, which seem to indicate an overarching superiority of the financially intermediated system over market oriented financial system, why do we observe a mix of markets and institutions? Also, why are certain economies biased towards financial markets while others are biased towards financial intermediaries? Allen and Gale (2001) examine these issues critically and conclude that it takes a certain degree of financial intermediation to activate a market for a financial security, while the depth of the security market allows financial intermediation to take place by overcoming the fixed cost of such financial intermediation. Thus, financial markets and financial intermediaries are strategic complements in important ways and not mere substitute technologies. They also note that in the presence of inter-temporal risk in a dynamic, overlapping generation framework, while it is true that the intermediated solution is superior, it is also true that the solution is not stable in the sense that during a period of positive shock, financial market can give a better return and thus unravel the intermediated system.

The broader problem of which the subject matter of this book is a part, is the relationship between financial systems and economic development. This relationship can be divided into two causal structures—(*i*) the impact of economic development on the development of financial systems and (*ii*) the role of finance in economic development.

Gurley and Shaw (1967: 257–268) proposed the thesis that there are alternative savings-investment technologies such as—self-finance, taxation, financial intermediation, financial markets and foreign aid that are adopted by economies in different stages of their history. They further went on to point out that along all such growth paths, financial deepening occurs due to the division of labour between production and consumption, savings and investment, and in the manifestation of financial intermediaries. Apart from the secular rise in the financial ratios, the first statistical regularity in the relation between finance and development, the authors also noted that there was significant variation in financial systems of different countries, as reflected in the variance of the financial ratios. The ratio of financial assets to real Gross Domestic Product (GDP) was shown to vary between 10–35 per cent in the case of developing economies and 50–200 per cent in the case of advanced economies. The factors identified as causing this variance were the different rates of output growth, inflation, historical factors and the legal framework of the different countries. It is to be noted that financial deepening occurs through monetary expansion, monetization of savings and investment, and a rise in the ratio of liquid financial assets to illiquid real assets. The thesis of Shaw (1973), that financial deepening occurs through the process of economic development and ends financial repression, carried on by a low and distorted interest rate regime, was hailed by many supporters of financial liberalization. However, there developed another school of thought, which, while retaining the essential argument for financial liberalization, required a different approach in implementing such a policy. This approach, developed by Mckinnon (1973), offered a view where money and capital were complements in less developed economies with fragmented capital markets. His prescription for such markets was a lower rate of inflation but a higher rate of real interest. What was necessary as a follow-up to the theses of Shaw and Mckinnon was an investigation of how different financial systems evolved in response to economic development and how the transmission mechanism worked. Goldsmith (1969, 1983) sought to track the development of national financial systems as economies evolved. He was successful in tracing the financial development of some important national economies and show that financial deepening occurred through development of banking systems as countries develop and that the importance of non-bank financial intermediaries and financial markets increased relative to banks with economic development. Goldsmith also attempted to find out whether overall level of financial development and financial structure had a causal influence on economic growth. However, he was unable to complete the project on financial causality due to technical problems like data limitations.

For ages, economists of different schools, whether a classical economist like Ricardo or a critic of classical political economy like Marx, an ardent Keynesian like Robinson or neoclassical scholars like Hicks and Lucas, have held the view that it is the return on real capital which drives capital accumulation process and that financial factors are only reactive and accommodative at best and tangential at worst to such a process. However, there have been exceptions. Bagehot (1873) argued that the Industrial Revolution could not have taken off in England without the operation of the financial markets which mobilized savings for risky illiquid assets. Long time back, Joseph Schumpeter (1911) argued that services provided by financial intermediaries are essential for unleashing the dynamic entrepreneurial potential, for providing the incentives for technological innovation, for mobilizing savings, for management of risks through project evaluation and monitoring, and so on. The presence of all these factors ultimately results in a high rate of economic growth and development in the Schumpeterian schema. Recent work has found supporting evidence for this view (King and Levine 1993: 717–737). Gerschenkron argued for a strategic role of public sector banks in the process of industrialization. Cameron showed that banking played an important role in the early days of industrialization in Western Europe, both directly through increasing the working capital and fixed capital investment as well as indirectly by financing the infrastructure development of these economies (1967). Among the recent scholars, the Nobel Laureate Merton Miller has noted that '(the idea) that financial markets contribute to economic growth is a proposition too obvious for serious discussion' (1998: 8–14). Recently, a number of authors have taken up the unfinished agenda of Goldsmith by constructing comprehensive cross-country, industry-level and firm-level data sets to show that the overall level of financial development has a positive impact on economic growth but that financial structure (the variable that indicates whether a country is bank-based or financial-markets-based) does not explain growth (Kunt and Levine 2001).

The more complete and accurate way of thinking causality is to acknowledge potential feedbacks between growth and financial system development. Among the modern generation of financial economists, it is widely accepted that financial development and economic growth interact with each other in a reinforcing way. Greenwood and Jovanovic (1990: 1076–1107) argue that financial intermediation increases the rate of return on capital and thus promotes growth; while growth allows the agents in the economy to implement costly financial structures and thus increase the extent of financial intermediation starting from a low level. Bencivenga and Smith (1991: 195–209) develop a model to show how financial intermediaries, through provision of liquidity certainty and through reducing needs for capital liquidation, enhance the rate of growth of the economy such that the higher rate of growth in turn increases the potential savings and investment into illiquid assets. Thus, they show that with financial intermediation there would be a higher rate of (endogenous) growth. Greenwood and Smith (1997: 145–181) point out that the development of financial markets improve risk sharing, liquidity and specialization, which raise the rate of growth, and the higher rate of growth leads to further development of financial markets by generating enough wealth to allow costly financial innovation. Acemoglu and Zilbotti (1997: 709–751) show that capital poor economies will, on average, tend to be poor for a significant length of time and growing into developed economy status will be subject to a large degree to chance. The low level of capital will imply that there will be limited spreading of risks through different projects. The desire to avoid highly risky investment will slow down capital accumulation and the inability to diversify idiosyncratic risk will introduce a large amount of uncertainty. The dynamic equilibrium path of an initially capital poor will be inefficient since there will be pecuniary diversification externality that will characterize the economy.

It follows from the theoretical literature discussed earlier that the financial system in general and banking in particular play a central role in economic development. It is the banking system which, through issuing and regulating the media of payments and mobilizing savings in the form of financial liabilities like deposits, through efficient screening and monitoring of entrepreneurial projects, allows the monetization of the economy and enables superior resource allocation possible through the division of labour. Banking translates economic growth into costly but useful financial innovations. These innovations in turn improve risk sharing, liquidity and the return on capital which leads to further economic growth.

Banking Theory Meets Institutional Reality

Among theoreticians, it is commonplace to argue that the rationale for the existence of banks can be understood in terms of the functional aspects of banking, which financial markets and other institutions cannot replicate. While the theoretical literature on banking captures the essence of the basic functions of a commercial bank in terms of transaction cost minimization, portfolio diversification, asset transformation, liquidity creation, risk sharing, risk management and means of payments creation, the literature is quite inadequate in explaining why and how some people choose to become financial intermediaries, how long lasting financial institutions are created and how the establishment of financial institutions create innovations that change the structure of financial markets in terms of risk-return-liquidity matrix of real and financial assets. In the context of a less developed country, the issues are perhaps best posed as follows—under what socio-economic conditions does financial entrepreneurship occur, what are the characteristics of these financial entrepreneurs, what kind of financial institutions are typically created and how are they related to the context of development, how do the financial institutions created survive the economic fluctuations, and what is the relationship between financial innovations engineered by these institutions and the changing financial landscape as the economy develops. That existing banking theory has little to offer on institutional realities is well illustrated by modern Indian banking history. In understanding the formation of indigenous banking in rural and urban townships in a less developed economy such as India, attention has to be paid to the fact that the emergence of modern banking through private initiatives had to contend with the development needs and political aspirations created by the colonial rule at the turn of the 20th century. Some knee-jerk reactions in the post-Independence period were to involve the State in resource mobilization and industrialization as well as nationalization of the banking industry. It is not clear how the theory can address these issues. Nor is it clear that the theory has progressed in understanding the phenomenon of 'financial entrepreneurship' in any great depth. Banerjee and Newman (1995: 274–298) suggest a theory of occupational choice and economic development, but they fail to capture the essential factors driving the occupational choice of the economic agents that create a class of 'financial entrepreneurs' through a complex process of intermediation. The timing of the birth of banking institutions is another issue—what are the market and institutional factors that lead to the introduction of a financial institution? In some countries it has been the possibility of colonial trade, in some others it has been political or economic revolution, while in some others it has been the need to finance war campaigns. While the glimpses of the answer are thus revealed sketchily, a complete characterization of the necessary and sufficient conditions has eluded the existing banking theory so far. The early *Swadeshi* banks had to contend with market forces without government backing and were thus subject to huge liquidity risks in the form of bank runs by uninsured depositors in an economy subject to convulsions like war, partition, famines and currency shortage. Management methods in banking were quite different compared to later times, when the liquidity risk was reduced through improved regulation, mergers and deposit insurance. As time passed, indigenous small-scale production required more finance than internal trade, and bill discounting became of lesser importance compared to advances for working capital and project finance requirements. Two decades of private banking, following Independence, saw growth occurring at a high enough pace to create a growth-financial instability trade-off. Compulsory and voluntary mergers ensured that banks would survive the financial and economic crises. The mergers also increased the concentration of the banking industry. Initially, development banking (for long-term project finance) was distinguished from commercial banking which largely catered to advances for working capital purposes and invested in financial securities. With the passage of time, this too would change as the commercial banks would resort to development finance (especially that of agriculture and small-scale industry) and project finance after nationalization. The change of ownership with nationalization created a new system of control, motivation and incentives, and public sector banks resorted to massive expansion in their scale and scope of operations, but with some adverse consequences on productivity and profits. Directed credit policy and interest rate structure regulation created rigidity in the structure of the banking system, while liquidity policy (implemented through bank rate adjustments, cash–reserve ratio and statutory liquidity requirements) ensured stability of the money market. While liberalization has made the interest rate structure and liquidity much more flexible than before, rigidity has been introduced in terms of capital requirements. An important issue is the mindset of the banking regulator—why was deposit insurance introduced so late? Why were banks allowed to fail in the banking crises before Independence? What role did financial stability play in banking regulation after Independence? Was nationalization the best way for banking to contribute to economic development? Is capital requirement really believed to reduce risk taking by banks? How did the mindset of the banking regulator change with new dynamics of the banking industry? All these questions necessarily require a historical mode of investigation where the institutional structure of banking is shown to change or not change in response to a set of internal and external factors. Although a lot has been written on the theory of privatization, the theory of optimal ownership in banking is simply not there at the current moment and all that we have is a cross-country survey which indicates the inefficiency of publicly owned banks. The relevance of public ownership of banks remains unchallenged as long as poverty and unemployment exists and as long as these two remain to a large extent, a function of the nature and workings of the credit market. Prudential regulation of banking essentially requires imposing capital requirements so that banks do not invest in excessively risky assets with depositors' money. Also, it is necessary to create a transparent and revealing accounting system. Two other measures are regulating the cash–reserve ratio and liquidity–deposits ratio. These take care of monetary policy objectives as well as liquidity requirements. But from the point of view of averting liquidity crises and financial panics, deposit insurance and lender of last resort (by the Central Bank) are of paramount importance. There is a rich literature on banking regulation covering such issues like deposit insurance, lender of last resort, capital adequacy, off balance activities regulation, and so on, but how public sector banks in developing countries like India should be regulated is an open theoretical question. One of the contemporary debates is framed around the issue of the extent to which there should be priority sector lending. On the dynamics of banking, current theory is still at an infant stage. Surviving in business is itself a difficult task and making positive profits requires all the ingenuity, innovation, conservatism, discipline, and so on, that the banker has. These core skills and behaviour patterns, as well as the external market factors get reflected in the balance sheet. Commercial banking under nationalization places significant social constraints on the banks. Maximizing the discounted sum of profits, while meeting these social goals, is an extremely difficult optimization exercise because of the resources, and the organizational and management requirements of such an effort. Conventional banking theory has been relatively silent on these aspects in the past. A new theory of banking which takes into account the institutional characteristics, especially those of less developed economies, will have to be content with the fact that abstract theory and historical details are not easily married. Perhaps, a partial way out is offered by the school of thought known as New Institutional Economics which allows theory to focus on the nature of essential transactions governing exchange and production, and to take into account the attendant transaction costs in order to explain institutions of the past and the present. Allen and Gale (1994) show how the structure of transaction costs can determine the structure of risk sharing and innovation in financial markets. In their theory, financial securities and institutions are endogenously determined and they suggest possibilities of multiple equilibriums with welfare rankings of such equilibriums. While such a view has significant potential in enriching our understanding of financial markets and institutions, it has to be strengthened by a more comprehensive notion and characterization of transaction costs. Unfortunately, theorists of financial institutions have not paid enough attention to the real nature of transaction costs in financial institution creation.

Organization of a set of financial assets of a given liquidity-risk-return structure (at the cost of a set of liabilities) and the management of assets and liabilities over time are the two key transactions that are essential for the creation and development of commercial banks. The first transaction cannot be understood without paying attention to the structure of the organizational form that it generates in terms of leadership mode, information communication mechanisms, delegation of portfolio management, decentralization of the hierarchy and the management of business processes. Each financial intermediary is to be seen as engaged in attempting to achieve an optimum portfolio of liquidity, risk and return subject to the structural constraints on the organizational transactions. The complexity of this process needs to be adequately captured before we can claim to understand the behaviour of banks and other financial institutions. The dynamics of the organization process unfolds as follows—a profit opportunity is discovered or visualized by the central entrepreneur; he organizes his core team in order to realize the potential profit; information is shared between the team; the hierarchy of reporting relationships is designed; the degree of centralization or decentralization is determined by the top management; and recruitment and operations begin with an initial financing arrangement made. Subsequently, the nature of liquidity, risks, and returns of assets and liabilities are mapped, and the optimum portfolio evolves through the passage of time. A special note should be made of risks and risk management. What we have today are a number of influential articles and books on risk management in banking, where risks are classified into different categories and each type of risk is only treated partially. However, such a literature cannot have the desired effect unless risks are integrated through structural constraints and unless risk management is seen as only a part of the organizational transaction as described earlier. The main task is then the integrated analysis of management of liquidity risk, market risk, credit risk and operational risk. With respect to risk management, historical data has to be used to arrive at measures of risks and returns. Liquidity management is another type of transaction that is costly because the bank or the financial intermediary has to promise liquidity in its transactions with depositors, borrowers and other stakeholders, while absorbing the risks of illiquidity. The risk of illiquidity can range from losses due to rapid fire sales of assets, to complete insolvency due to claims on the intermediaries overtaking the liquid value of assets during bank runs. In order to manage liquidity risks, the bank management has to assess the distribution of types of liquidity claimants and maintain a diversified portfolio, where a minimum proportion of depositors and borrowers are those with a low discount rate (late withdrawers). In addition, the management has to provide for liquid reserves of cash and short-term securities. Even these safeguards may turn out to be inadequate and the bank management has to have an access to a liquid money market at all times. Even if such a market malfunctions or becomes prohibitively expensive, then the bank management must have enough collateral securities that can ensure borrowing from the Central Bank. What are the costs of these activities?

Can such costs be reduced to a single type of cost known as transaction costs? The answer is not straightforward and lies in the ability of theory to reduce a complex set of heterogeneous transactions to a homogeneous category and assign costs to it. In order to manage credit risk, the bank management has to screen the borrowers, ensure security guarantee in the form of collateral, provide incentives for repayment, have a well diversified group of borrowers and insist on loan covenants. With deposit insurance, bank run risks are obviated and it is thus not possible to say whether the Indian banks are over or under-diversified in liquidity risks. However, it does seem to be the case that most of the Indian banks are not well diversified with respect to their credit portfolios which are concentrated in specific industries in specific regions. With regard to costs, it becomes clear that Indian public sector banks have high fixed and variable costs when compared to the foreign banks which follow the best practices in banking. High staff strength, the disruptive effects of unionization, low mechanization, and lack of efficient and trained personnel in the required amounts are some of the well known arguments that seek to rationalize such high costs. Thus, it cannot be said that operational risks have been minimized. To reduce the sum of these risks, subject to a certain degree of liquidity maintainable as the minimum and subject to a certain minimum rate of return on assets or profitability, constitutes the transaction costs of the banking organization. Theory is silent on how to define the problem and characterize the solution, mainly because the reductionist, abstract modelling methodology of theory fails to deal with such a situation of inherent non-reducible complexity.

Strategy is the bridge between the organization and the external environment that maximizes the value of the bank assets. The fundamental function of a banking firm is to absorb, share and transfer risk, while at the same time managing its risk exposure in the process of transforming liquid liabilities into illiquid assets and generating private media of circulation. The complexity of tasks when put together with oligopoly markets and stakeholder satisfaction requirements, makes it imperative that a bank has a clearly defined strategy at any stage of its life. On the other hand, such a strategy has to take into account the resource constraints of the organization, specific capabilities and assets as well as the nature of the organizational networks and hierarchies. The determination of strategy requires cognitive and motivational effort from the top management. Sometimes the right strategy will not be selected since the management has a bounded vision and limited computational power while, at other times, the management as a constituency will choose a strategy which is optimal for the management but not for the bank. These constitute the major transaction costs in strategy building. The fundamental tasks of a management team in an organization are the following—to have a clearly defined mission or vision, determine an optimal strategy with respect to that vision and then implement that strategy through the right organizational structure, correctly aligned incentives and corresponding business processes. A bank's management may have a vision of the future where the bank transits from a local player to a global player, another bank may choose to define a path for itself in terms of growing competence and profitability in certain core areas of operations, while still another may focus on a future as a strong micro-credit institution. Theory tells us that the perceived growth of the market for bank assets and liabilities, the risk preference and the discount rate of the management may affect the vision that a bank ultimately has, but there is more to it than just these variables—psychology of the seed capital provider and that of the existing shareholders can affect the vision; so can the perceived areas of comparative advantage, and core competence and the modes of imagining the future have the final say, of course. Theory has still less to say on what should be the right vision of an organization in a given circumstance. This is particularly troubling since a faulty vision and mission can have a disastrous effect on an organization. In the Indian case, directed credit programmes through the nationalized banks have resulted from a vision which is still shaping the destiny of the public sector banks. It is important to know to what extent such directed credit programmes are part of an optimal vision. Two other important issues are strategic privatization and mergers of public sector banks. On all these aspects, the theoretical literature is basically silent and for the good reason that theory and institutional data are hard to combine. Given these considerations, the economists and management scientists should focus their research on the evolution of a strategy of banking. Historical case studies should be used in conjunction with theoretical reflections.

Even when a typical theoretical model in banking is well developed in terms of addressing a policy issue, it is nonetheless constrained by the methodology of formal modelling and can only address one or two issues at a time. Yet, the interdependence of the entire set of issues cannot be denied and the policy questions need to be addressed in a manner that recognizes the nature of this interdependence and provides a comprehensive framework. What we offer instead is a narrative that is informed by theory and data. The focus of attention is on a bank in a less developed state of a developing country. Thus, we have been led to choose a representative bank in the state of West Bengal in India and its neighbouring states of the east and north-east.

Banking in a Less Developed Economy

Bengal in the late 19th century and early 20th century (and some would argue even the second half of the 20th century) was a classic case of a less developed economy. On the one hand, Bengal was recovering from the de-industrialization and failure of business enterprise in Calcutta, and, on the other, it was trying to accommodate new industry and redevelop indigenous banking after the decline of the house of Jagath Seth and other *kothi*s (Sinha 1984). The economy was also trying to adjust to the surplus extracting land revenue system with oppressive rentals extracted by the landed proprietors and to the failed institutionalization of agriculture through commercialization. There was a general shortage of indigenous capital and physical, financial, organizational and social capital that could effectively neutralize the burden of colonial land revenue and surplus extraction system, and the dominance of the British commercial firms. Bengali entrepreneurs, discouraged from forming indigenous industry in urban areas, dominated by commercial interests of the British mercantile firms, turned their attention towards the village economy in the hope of making profits from trade and finance by substituting for the oppressive money lending class and other mechanisms. It is in this context that the indigenous banking of the *mofussil*s sprung up. These banks grew in size and expanded their branch network both in urban and rural areas and contributed to regional economic development. However, not being sufficiently diversified geographically, the fortunes of these banks were tied specifically to the development of the Bengal economy and generally to that of the eastern and the north-eastern states. Most of the small banks did not survive the recessions and depression of the first half of the 20th century (Debnath 2003).[2] But despite maintaining the strong position in Bengal and the north-east of those remaining survivors after Independence, these banks could hardly geographically diversify their asset-liability portfolio by penetrating in other states of India. In the second half of the 20th century, economic planning led industrialization led to the beginning of the process of economic development in the State. The continuing emergence of the British mercantile firms created capital, organization and employment opportunities. The growth in trade and agriculture allowed the bank to increase its bills discounting business. But the primary reason why the 1950s and 1960s saw high growth of the bank assets was due to the industrialization projects in Bengal and the eastern states. Unlike other time periods, this was one when the Bengal-based banks' contribution to regional development fetched them healthy returns. This was also one of the reasons why the banks did not feel the necessity to diversify geographically across India. As a consequence of their limited geographic diversification, when the decline of the Bengal economy started, the banks were badly hurt. The decline of the eastern region started when the demand for jute products fell in the world market, the electrical and mechanical engineering industry saw a declining demand and afterwards, the poor performance of the north-east in exporting tea to the rest of the world. After nationalization, the responsibilities of development banking in eastern and north-eastern states further increased. And all along, the Bengal economy was performing poorly, increasing the pressures and worries of successive bank management teams in Bengal. The banks had to fight against all odds with an increasing share of Non-Performing Assets (NPAs) in their asset base of the different firms in Bengal. The deteriorating law and order situation in the north-eastern states caused further worries and problems in loan recovery. The bank managements had to overstretch their organization methods and strategy to sustain the spirit of prudential banking in the middle of these setbacks.[3] Nationalization, with its emphasis on high growth of priority sector lending, stretched the resources and the organizational skills of the banks. The banks were able to meet the challenge admirably and contributed to the economic development of small peasants, artisans, traders, transport operators, and so on. The continuing contribution of the development banking role of the banks has been the most dominant feature in the post-nationalization era. Unfortunately, the banks did not get back the return in proportion to their contribution. Industrial sickness in key sectors like jute, tea and heavy engineering, poor performance of agriculture and outflow of capital in Bengal brought about by militant labour unions supported by the ruling Left, lack of industrialization and development in Orissa and Bihar, and the disrupted law and order situation in the north-east robbed the banks of the chances to achieve a high return on its assets.

For a historian of banking, the following basic questions are thus foundational in historical investigations:

(*a*) What is the notion of banking in a less developed economy?
(*b*) How does banking contribute to economic development?
(*c*) On what set of factors does banking depend for existence and survival?

In the context of the banking history of Bengal in the late 19th and the 20th century, these questions are obviously important. In what follows, we shall offer some tentative answers but first we place the questions in the proper historical context. First of all, there was no clear idea about banking in the early days and as such pecuniary liabilities could be easily shifted. Even when necessary legislation was enacted, there remained regulatory loopholes that could be used to take advantage of the depositors and investors of a joint stock bank. With time, the shifting yardsticks of policy made it even more difficult to pinpoint the boundaries of the structure of banking. The notion of banking was inextricably linked to certain habits of the depositors and borrowers such as the habit of small savings, the habit of timely repayment of interest, and so on. Thus, banking was not merely an industry but also a part of a larger *financial culture*. Trust was the core of this financial culture, as an important thinker and financial journalist of the time explained. In fact, the financial press was playing an important role in explaining the notion of banking to the general public in terms of explaining financial terms and usages, the notion of pooling resources under a safe umbrella, and in analyzing and making sense of financial data. What emerged from all these discussions was that banking was an institution which transformed liquid liability into illiquid assets under conditions of both uncertainty and trust. Thus, it was an inherently risky business subject to bank failures and runs. This risk made it necessary to monitor banks closely and eventually led to a system of Central Bank supervision and control of the industry. However, the disclosure law was against the general shareholder and allowed inspection of assets of a bank until the investor could show that he owned one-fifth of the shares. This was neutralized by an amendment to the Banking Companies Act in 1936. The amendment provided a clear definition of a bank as principally a depository institution and publicly accountable in such a role. However, some loopholes emerged and the law would have to be spelt out in greater detail soon to curtail risky lending practices of loan companies. Banks would be restricted by capital requirements and liquidity requirements, and the notion of the principal role of the bank as a depository institution was taken away by subsequent legislation. The second question was important in the sense that a certain section of the community saw banking as exploitative in nature and a tool for economic deprivation or elitist. This kind of feeling was due to the usurious moneylenders in the villages who dispossessed poor peasants from their land and due to the denial of services to natives of small means by city-based British mercantile banks. Some indigenous banks did business and some banks were emerging in the *Swadeshi* spirit, but sceptics held such developments as doomed for failure as banking was never meant as an egalitarian economic tool. Only some financial writers like Benoy Sarkar dissented and argued for a culture that encouraged bank formation, bank capital and deposit accumulation. It is in this context that the success or failure of the indigenous joint stock banks needs to be judged. Much later, when nationalization of the banking system was invoked to reach the agriculture and small-scale sectors, the question had been partially answered but the impact of banking on development had become an empirical issue. The third question arose out of the social experience of indigenous joint stock bank formation in the late 19th century and the recurrent bank failures in the late 19th century and the first half of the 20th century in Bengal.

The small cultivators, sharecroppers and the landless labourers in the early and mid 19th century depended on credit needs on the village moneylenders, local traders or the *zamindar*s. The credit requirements were of two types—consumption loans like money for buying food during a bad harvest, money for illness, *shradh*, and so on, and production loans like money for buying seeds and water. Frequently, contracts were interlinked and labour at the field of the landlord would buy credit in the form of wages. The moneylenders took advantage of their monopoly positions to charge usurious rates of interest. These moneylenders were bankers rather than financial intermediaries in the sense that they invested their own capital. Almost always, the small farmer was a net borrower rather than a lender and this meant that, on the one hand, there was no wealth accumulation through deposits and, on the other, there was loss of tangible, pledgeable wealth to the lender through the activation of the forfeiture clause in such credit contracts. Competition between moneylenders scarcely occurred, as they either formed an implicit agreement on the rate of interest on loans or located themselves through spatial differentiation to avoid competition. The small cultivator was thus being systematically exploited and developed an animosity towards the moneylender or *zamindar* class, which found its voice in the numerous peasant revolts. Thus, the very basis of exploitative banking was challenged. On the other hand, the indigenous *Swadeshi* banks of the *mofussil*s were welcomed since social and political leaders were associated with these banks and the banks had a clear developmental orientation. In these banks, the public learnt to trust their money with deposits and, for the first time, got accustomed to withdrawing their deposits as per need as well as availing of credit requirements. With the spread of banking habits, the public would accept bank notes and cheques as a medium of circulation and learn to economize on the savings deposits. The emphasis would shift from exploitation by rural moneylenders to development of small savings or the cultivation of *Lakshmi*, as the Bengali household would put it. Most importantly, resources hitherto locked into illiquid factors such as land, premises and equipment were released by converting the latter into liquid assets. This was further facilitated by the boom in jute and the cotton industry which brought surplus funds in the hands of the weavers and cultivators with potential for savings in financial institutions that could command trust. Banking was thus increasingly seen as a modern monetary institution which could be activated by the trust reposed in the financial entrepreneur by the depository public and where deposits would play an as important role in generating assets as the own capital of the financial entrepreneur. However, what was not clear was the role of the State in maintaining this institution of trust and in creating disciplinary devices such that banks would not take excessive amount of risks. What was also not clear was the extent to which banking was a social institution and had to be commercially operated. Nationalization sought to answer these questions through its emphasis on an ambitious plan of expansion of the branch network of the nationalized banks and by emphasizing the priority sector lending of the banks that would help the households engaged in agriculture and trade. Some of the Bengal-based banks, through their branch expansion programmes, have become household names in Bengal and have played a major role in mobilizing small savings and promoting the savings habit of the community. On the other hand, they have successfully reached the small farmer, the artisan class and the small trader. This is perhaps the core notion of banking in the second half of the 20th century.

In the 19th century, indigenous banking was seen as an important contribution to agriculture as it was less exploitative than rural money lending and lent stability to agricultural working capital finance. Industry in the cities and *mofussil*s received a greater marginal share of working capital finance and it also got fixed capital finance from the Indian joint stock banks. Banking was playing an important role in development by helping the structural transformation of the economy from agriculture to at least one of partially industry-based. Even in agriculture, it contributed to commercialization that had a higher return though it also resulted in significantly higher indebtedness and dispossession of small peasants from land. The availability of fixed capital freed resources for industry to invest in working capital and expand in size and scale. Though credit was rationed to a significant extent for the small borrowers, there was a general surge of credit at the turn of the new century. But the periodic dislocations of the economy created uncertainty to which people had learnt to become increasingly averse and the general situation demanded a new role for banking—that of smoothening out the financial fluctuations. This would not happen until a central bank was created, until bank bailout mechanisms were fixed in terms of mergers and deposit insurance, and until banks learned to invest prudently in reserve assets to meet contingencies. However, with Independence, this stabilizing role of banking was shifted to a large extent (along with many other responsibilities) to the government, and new government and quasi-government institutions were created with the responsibility of development banking, such as long term industrial project finance, and refinance and agricultural investment credit refinance. The commercial banks concentrated on working capital finance of industry and trade finance through bills discounting and to a lesser extent on agriculture (though tea finance was a significant part of the portfolio of some of the Bengal-based banks) and small-scale industry finance. With nationalization of the banking system, the official aim of banking became one of maximizing savings mobilization and credit off-take for agriculture and small-scale industry. This was the essence of development banking and the concept found further refinement in the development of the lead banking scheme, under which each bank took responsibility of the overall economic development of some districts where the bank had or was designated to have a major presence. Thus, banks were forced to develop the viewpoint of the savers and borrowers and think of numerous schemes to increase their participation in the local and regional economy, and play a major role in their socio-economic upliftment. The commercial orientation of banking, which was sacrificed to a large extent, has been offered as the reason for the banking crisis of the last decade. Today, the possibility of the marriage between the social responsibility of banking and its commercial orientation looms large as the policy makers seemed to have learnt significantly from past mistakes. That there is no conflict anymore between the role of development banking and commercial orientation in banking does not mean that banks will withdraw significantly from priority sector lending and mobilizing small savings, but rather it implies that the development banking activities will be done more prudently, so that both bank clients and the bank get a healthy return.

Apart from the general good fortune created by good harvest, high exports, investment and boom in commodity markets, the institution of banking exists and survives on the basis of three factors—diversified asset base, financial entrepreneurship and trust. Diversified asset base is important so that there are no excessive risk exposures to particular firms, industries or regions. As mentioned before, the major Bengal-based banks could not sufficiently diversify geographically across the

Indian states when the decline of the Bengal economy started. Thus, the Bengal-based bank had to share many adverse risks with its Bengal clienteles. Entrepreneurship is a scarce factor of production and financial entrepreneurship even more so. Those who had the maximum chance of becoming bank entrepreneurs were the lawyers who had enough seed capital, enough experience in handling bank documents, bank cases and enough knowledge in terms of where capital earned high returns and where it did not. But it is one thing to start a bank in a *mofussil* town and quite another to handle adroitly the daily operations of the bank. Whenever a financial entrepreneur was guilty of corruption, fraud, and so on, the bank run by him was surely on its way to ruin. The real question was under what conditions would the financial entrepreneur behave in an honest, responsible and efficient way. Surely such behaviour would require oversight from the depositor, banking industry regulator and the State. At the turn of the 20th century, there was a notion that a comprehensive banking law had to be drafted which would take care of all evil. Although banking was not separately treated in the Companies Act between 1913 and 1936, it was nonetheless to a certain extent protected. But even after a special provision was made for banking in the Companies Amendment Act of 1936, banking crises due to corrupt bank management did not subside. The public realized that the industry needed a regulator who would monitor banks closely and discipline them if need be. Trust of the people was hard to win for the indigenous banks, but quite easy to lose. In the absence of deposit insurance, the general public kept a close watch on their banks and the slightest negative rumour had them running to the banks to reclaim their money. Banks which had historically been paying all claimants irrespective of the demand of liquidity and those that kept a high degree of liquid cash reserves were those that were spared random runs. Those banks which were inclined to take a risky illiquid asset portfolio for future return were in constant danger. With the establishment of a central bank and the introduction of deposit insurance, banking became relatively safer. However, in the eyes of the depositor, the idea of safety was introduced by nationalization. There was the implicit and explicit trust that a nationalized bank, being a government property, would be under constant monitoring and scrutiny, and would not be allowed to fail. The fact that some of the weakest nationalized banks have survived the NPA crisis through recapitalization of the accumulated losses indicates the commitment of the government to stand by its banking constituency in times of crisis. Further, there is prudential supervision and the lender of last resort policy that the Central Bank can use to help a bank in liquidity crisis. Lastly, there has been insurance of deposits under which deposits are relatively safe, even if not fully covered. Thus, institutions have arisen to make banking safer and highly liquid. However, in times of loss, the government had to bear the ultimate brunt through the taxpayers' money. We have not witnessed banking crises like those in East Asia or the Nordic countries because losses made by the public sector banks have been converted systematically into a portion of the fiscal deficit. Globalization through free flow of capital will provide many opportunities for the Indian banking industry but will also severely test its risk management and lending prudence. Not all liabilities can be shifted indefinitely onto the government in the future and the Indian banks have to take special measures in business operations and strategy to meet the challenges.

An Institutional Narrative

Williamson argues that the institutional process has to be understood in the context of limited cognitive abilities of entrepreneurs in the making and the moral hazard embedded in small transactions (1985). North defines institutions as formal and informal constraints. In his definition, organizations are created by human interaction constrained by such rules (North 1990). However, our definition is broader in the sense that it sees institutions as governance structures and focuses on the constraining as well as the enabling role of institutions in social, economic and political transactions. They can be rules, organizations, contractual modes and even the rare citizen whose missions survive the ravages of time. This tentative definition suggests that in the course of investigating institutional change and performance, there is always a critical discovery process for analytical primitives of structures. Further, there are transactions that are 'institution creating', 'institutional development' and those causing 'institutional change' that are fundamental in understanding institutional evolution (North 1990).

The institutional narrative that we offer here identifies an important institution, an Indian public sector bank and tells the story of creation, management and change of such an institution. Trying to tell a story of a group of banks was a less desirable alternative for us, since when the group is not homogeneous, as is almost always the case, any account of causality would have to be suspended by the divergent experiences of the individual members of the group. On the other hand, trying to tell a narrative of an entire industry through the reflective accounts of a single bank runs into dangers of oversimplification and misrepresentation. Therefore, our strategy has only been to characterize the essential nature of banking in a less developed economy when looking into the world of commercial banking through a single bank. The purpose of the narrative is to capture both the essence of the process of development of commercial banking as an institution and its implications in the context of a less developed economy. The narrative is cast in the background of developments in the Indian banking industry, on the one hand, and that of less developed eastern and north-eastern states centring around Bengal, on the other, and thus engages continuously with the issue of what and how well the narrative represents the story of the industry and that of the less developed economy. The strategy of the narrative is to bring in the special features of banking as an institution through discussion of the leadership mode, strategy, information communication mechanisms, delegation of portfolio management, decentralization of the organizational hierarchy, management of business processes, transaction cost minimization, portfolio diversification, asset transformation, delegation and authority, incentive structures, liquidity creation, risk sharing, risk management, means of payments creation, asset-liability management, risk management, scale and scope, ownership issues, banking regulation, industrial relations, and so on. The narrative also tries to highlight human agency in the central role in terms of causation and analyze the agency in terms of incentives.

We have chosen United Bank of India (UBI) as the financial institution to be studied and we have done so for a number of reasons. First of all, UBI has been one of the most prominent of the Bengal-based banks since Independence. Second, the bank has survived the exigencies of time and the ravages of financial and banking crises. The roots of the bank go deep to as farther as 1914, so as to warrant a proper historical investigation of the origin and evolution of the bank. Third, the bank was formed in a unique way through a negotiated merger between four of the constituent banks in order to escape a virulent and episodic banking crisis. Fourth, the bank has grown in a commendable way since Independence and particularly since bank nationalization. Fifth, the bank was caught up in the NPA crisis during the liberalization era and got a 'weak bank' stigma attached to it. Last, but not the least, the bank has turned around remarkably and looks poised for a healthy growth in recent years. The diversity of experience that the bank has accumulated reflects greatly the Indian experience with banking as an institution. The reflection is more accurate when one thinks of the experience of banking in Bengal and the other eastern and north-eastern states.

The way we have chronologically ordered the chapters may or may not be to the liking of the individual reader. We have relied on changes in external business conditions and policy environments to identify different regimes and differentiate between one regime and another. Alternatively, one can take a time series approach to test in each case whether there was a regime change in the important behavioural equations. However, this would require detailed data on the depositor and borrower profiles since the early days, which are simply not available and too difficult to sort out within the resource constraints of this project. However, we have constructed time series of important variables and ratios from 1950–1994 and attempted to show the patterns of structural shifts by analyzing the growth path, volatility, risks and returns. We hope this does make up for the lack of full scale econometric testing to some extent.

It is well recognized that banking is based on trust but the micro-foundations behind such an idea of banking is not fully captured in the theoretical literature that is more concerned with the different aspects of bank runs that liquidity of deposit contracts generate. Nor is the idea of trust playing a key role emphasized in histories of individual banks. In this narrative, *trust building* or *institution building* transactions play an important part, time and again. The reputation enhancing investments of Mr B. K. Dutt are the key transactions during the early development phase of the bank, as the bank develops from a local one to a major metropolitan bank. The earliest example of trust building lay in carrying liquid assets so that depositors could withdraw anytime without feeling inconvenienced, providing timely services to lawyers and other clients in the local courts, creating inter-bank deposits in larger banks, and so on. But the biggest example of trust-building transaction was the merger that led to the formation of the UBI. The merger arose primarily from an attempt to weather the runs on the large banks in Bengal. The managements of the merging banks felt that a large merged bank would restore the confidence among the public that was prone to panic and this indeed turned out to be the case. The theoretical literature on bank runs mainly suggests deposit insurance or lender of last resort as the safeguards against bank runs, but the idea of bank merger as a deterrent to bank run is not discussed. This story should provide some humble thoughts for the banking theorists. Another important trust building phase was during the first few years of nationalized banking when financial deepening at the countryside had to be achieved by the commercial banks. The essential transaction was opening of a branch in a remote geographical area (with significant savings potential but with little actual savings) and appealing to income earners to save with the bank using rural publicity campaigns and demonstrations.

Transactions that created *institutional development* for the bank during different phases can be categorized as organizational restructuring, management restructuring and balance sheet restructuring transactions. Inter-regional growth ambitions of the post merger years and the challenge of high-paced growth created by nationalization created the incentives to restructure the organization to be functionally capable of meeting the projected requirements. The main transactions that drove these post-merger and post-nationalization growth processes were those that created decentralization, delegation and lengthening of the management hierarchy. To be sure, these transactions were not achieved overnight but had to fight hard against established and habituated methods of monitoring, control and allocation of decision-making authority. However, once a threshold was attained in terms of a critical mass of transactions, the victory would become inevitable. The restructured organization would be especially suited for reaping the potential economies of scale and scope in banking. Organization restructuring would not do the required job alone and had to be supplemented by management restructuring. The latter was done through improving the Management Information Systems (MIS), building a formal risk management process compatible with international standards, improving the retail credit operations, restructuring the personnel, providing the required incentives in the pay structure and through improvising the human resource development policy of the bank. Balance sheet restructuring mainly took the form of capital injection by the government, refinancing, securitization and restructuring of bad loans, a rise in the investment to advances ratio, growth in retail credit, and greater and improved diversification of the loans and advances portfolio.

Transactions that led to *institutional change* were both externally imposed as well as internal manifestations. Such transactions were of three types. The first was the phenomenon of nationalization that turned the bank into an organization where socio-economic development of different groups of economically weak savers and borrowers, who previously did not have full access to banking, became the primary responsibility of the bank. The bank became far flung in terms of its branch network and innovated many small saving and lending schemes. Special attention was given to irrigation and marketing in agriculture, to savings mobilization and to increasing trade finance. The area approach to agriculture was invoked with considerable care and skill. Operations and planning were developed in accordance with the regional development plans. The contribution of nationalization and lead banking have been spread throughout the eastern and north-eastern states and speaks volumes of the bank's effort. The change had some adverse consequences on the return to assets and branch profitability, though this channel became the second institutional change. The heightened risk exposure of commercial banks, detected through an accounting regime shift, transformed a large proportion of bookable income and quality assets into non-bookable income and NPAs. The risk appetite of banks and the regulator was hurt significantly and UBI management became particularly risk-averse as their balance sheet was severely affected. However, this turned out to be a blessing in disguise as the risk management systems of Indian banks were significantly improved as a result of the crisis. A reorientation to commercial banking saw a more prudent management of the priority sector and large borrower credit accounts. The third transformation was in the explicit recognition of the bank that strategy and business processes were the key tools for sustainable growth and high rates of return. The recent management efforts to maximize the share of the bank in the retail sector, to focus on motivation and incentive schemes for employees, and to improve the information technology in business processes bear ample testimony to that.

Contemporary Policy Issues in Indian Banking

Recent debates on Indian banking have been framed in terms of themes of ownership, regulation, industrial structure and bank management. Some distinguished journalists, politicians and academicians, Chambers of Commerce and certain captains from the industry have voiced their concern over the inefficiency of the publicly owned banks and have argued in favour of privatization. This has been met with hostile opposition by the bank unions and with lukewarm response from the government. The debate is by no means closed and it is instructive at this juncture to make an appraisal of the achievements and failures of the nationalized banks, attributable to their public ownership. Some argue that regulation of Indian banks have evolved in an ad hoc manner and has been excessive, and that the capital adequacy standard imported from abroad and imposed arbitrarily on them have tied their hands to an extent that is detrimental for efficient functioning of the bank management. The opposite view is that banking policy has been efficient in an evolutionary sense, that constraints imposed by regulation were necessary for the efficient functioning of the industry and that recent regulations put in place have been chosen in pursuit of prudential regulation of banking. The opposite view, in fact, goes on to say that more restrictive measures are needed on the commercial banks in order to make the banking industry competitive, safe and stable. As far as the structure of the banking industry is concerned, the current debate is in terms of size, scope, innovation and competition. While no one really argues that one size fits all, there is a growing tendency to argue in favour of bank mergers in order to tap the potential benefits of economies of scale, scope and other synergies within a short period. It is further being argued that commercial banks should enter into related business like term lending, insurance, fund management and underwriting of securities. Advocates point to the growing volume of retail products to argue that expanding scope and scale creates further value through stimulating financial innovations by the commercial banks. The argument against seems to rest on the potential risk enhancement that comes with increasing scale and scope and particularly with innovative universal banking. The issue of competition has been thrown open since the liberalization of interest rates and is currently being framed in terms of the relative efficiency of foreign as well domestic bank entry in the Indian market (the proponents argue that this will further reduce financial repression through reducing the basic financial intermediation *spread*). Critics argue that increasing competition can increase the fragility and instability of the banking sector. They have a more *cooperative hierarchy* structure in mind, in the sense that commercial banks will cooperate with regional rural banks and micro-credit institutions, which in turn will cooperate with the primary agriculture credit cooperative societies. The supporters of the *laissez faire* school in banking argue that competition and control rights should induce optimal management of the banks, but admit that neither competitive forces nor control rights are perfect in the Indian scenario, leading to severe agency problem in Indian banking. In this context, they argue for bringing better accountability and higher transparency in bank management, both through improving corporate governance and creation of right incentive structures. At the same time, they argue that bank management practices in Indian banks are old, antiquated and inefficient, and warrant significant infusion of current best practices through proper recruitment, training, motivation and incentives. Such improvements, it is argued, is unlikely to be forthcoming without bank privatization. The opposite school refuses to accept the hypothesis that management cannot be improved at the Indian public sector banks without privatization and argue that the success of bank nationalization is attributable largely to the management effort in the nationalized banks. All these issues have to be resolved through both theoretical as well as institutional work and historical narratives like this one may play instrumental role in such debates, through highlighting important inductive arguments that bear on important causal relationships.

Notes

1. Sometimes commercial banks are only depository institutions while some financial institutions like moneylenders lend from own capital. In such cases, a distinction can be made between the narrow concept of banking as a depository institution or a lending institution from the broader concept of financial intermediation.
2. Between 1913 and 1917, about 78 banks were closed in the Indian subcontinent, from 1922 to 1932, 373 bank closures occurred, while from 1937 to 1948, a total of 620 banks were closed.
3. Only in recent years has the bank decided to seriously embark on an ambitious geographic diversification programme of branch expansion, covering the most affluent and well-to-do states of India.

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1

THE ROOTS

Part I: A Socio-economic History of Banking in Bengal[1]

Part I introduces the economic and social background to banking in Bengal. In the first part of this opening chapter, we examine the monetary conditions and credit markets. Next, we retrace the evolution of Bengali economic entrepreneurship through a social history. Finally, we examine how the Bengali nation reconstructed the institution of banking.

Money and Credit in Colonial Bengal

Economic historians have emphasized two basic features of the colonial money system. The first was the remarkable stringency and inelasticity of money and credit supply. The second was the fragmented nature of the money market. Both of these features persisted well into the 20th century in Bengal. The former was the result of the colonial need to control the money supply of a society, predominantly in terms of the external exchange rate of its currency. Apart from the colonial government tinkering with the rupee's external exchange ratio, another problem was the enormous amount of public debt raised by the state in the 20th century to finance its two major war efforts. This caused a further withdrawal of much needed capital from private trade and industry (Bagchi 1972). Why did domestic institutions like indigenous banks not form adequately early enough to rectify this deficiency? In the first place, the development of domestic financial institutions was constrained by the nature of money, which was primarily fiat money and commodity money. Had there been a more popular use of paper money (broadly defined to include bank notes, bills and cash credit), then it would have been easier to circulate money in response to regional needs. To the extent that there was a tendency of financial innovation and proliferation of domestic bills of exchange, it was restricted by the limited circulation of fiat money at the apex of the financial pyramid. Second, the notion of banking was primitive with only money-changing and limited lending within regions, characterizing the essential functioning of banks. The government was satisfied with the scheme of banking in urban areas consisting of Presidency banks and the Exchange banks, and it had no incentive to develop domestic banking activity as an institution that could create a more elastic money supply in distant places and higher liquidity for local production and exchange. The third reason had to do with the technology of *Swadeshi*—in early 19th century, *Swadeshi* was not conceived in terms of a strategy broad enough to encompass domestic economic institution building. Last, but not the least, was land relations—with Permanent Settlement, the British had defined the entire Bengal economy in terms of land assignment rights and land revenue obligations. With such a vital pre-modern factor of production thus anchored, a majority of credit and product market relations were subsumed under the rent relation. Only when pressure was applied to these relations did the latent forces get activated and indigenous banking become part of a serious economic history of Bengal.

The second matter of the fragmented nature of the so-called underdeveloped Indian money-market—quoted mostly by colonial officials in inquiry reports and government files—is, however, more complicated. The complaints were many—that indigenous bankers made interest rates vary between seasons, even between debtors, often causing them to move in opposite directions at the same time, and that all this made monetary control and management impossible in India. Bagchi (1997), however, shows that this was not peculiar to the Indian credit market but to late 19th century England as well. Also, if Indian *bazaar* lending rates seemed highly volatile, *sahukari* or inter-banker rates emerged as highly stable over the years, implying that credit was rationed and rates were engineered by locals, no less than by the Presidency banks—this being a matter of market politics rather than of any intrinsic market deficiency *contra* an achievable market ideal (1997: 43). If the local money market was marked by differential interest rates—lower for the rich or those belonging to the community of the *sahukar* himself and higher for the *adivasi*s—the Bank of Bengal too practised racial discrimination openly, favouring British agency houses, mines and plantations, maintaining 'opinion books' on various indigenous customers, blocking them in ethnic terms and in times of credit-rationing, and cutting off entire communities deliberately from bank loans and discounting services (Bagchi 1997: 52–53). In the early 20th century, the idea of a perfectly united and uniform money and credit market was a dream anywhere, perhaps it still is. And it certainly was a dream in a colonial-capitalist world based on racist and political discrimination.

But the nature of the fragmentation of the credit market was more subtle than that. Sugata Bose has shown persuasively how in early 20th-century Bengal 'rent itself had...become less important as a means of surplus appropriation than the credit mechanism' (1994: 248). During the depression, the fairly elastic and informal nature of 'grain-lending' was replaced by a much more rigid system of 'selling grain on credit' (Banerjee 2001). Indeed, the mechanism of redistribution of grain, which kept the peasant family alive over the lean months and in bad years, largely shifted from the domain of the credit market to that of the product market. This was done through the lending by the rice, pulses, jute and silk traders, who would now emerge as competitors to landed proprietors. The traders would charge a usurious rate of interest and the small cultivators would be forced to part with their harvest earlier, leading to deprivation. There would also be situations of debt trap such that the trader could leverage the weak bargaining position of the peasant and enforce a higher rate of future repayment and collateral hypothecation. Even when the depression lifted, the rural sector could not recover its place in the credit network, despite government interventions in the form of mortgage banks and co-operative credit societies. And since the supply of grains was taken out of the domain of credit and put into the orbit of sale and purchase, the agrarian economy was subjected to the convulsions of the war-time product market, with famines looming large in the horizon.

Why did the fragmented nature of credit markets persist? Why did financial arbitrageurs not borrow cheap in the urban market to sell credit dear in the rural markets, and in the process integrate the two market institutions? Historians and theorists have pondered and debated at length on this issue. While historians have rightly pointed out at colonial monetary and banking practices that led to credit market fragmentation, they have also pointed out that such a situation had its roots in the structure of colonial governance and should not be seen as a simple binary of urban/foreign versus rural/indigenous dualism. Theorists, on the other hand, have argued that higher rural interest rates reflected higher risk of default in rural markets or monopolistic pricing by moneylenders or interlinked contracts where rent could spill over onto the terms of credit. One may again ask why, as in the case of colonial currency shortage and uncertainty, domestic financial institutions did not develop adequately to integrate credit markets. The answer would be the same, except for the additional argument that domestic financial institutions like loan offices were constrained by limited capital, the same commercial motives and greater social transaction costs than that which characterized the usurious moneylenders.

To be sure, there was a demand for institutional change which would create a more elastic money supply (especially in times of crises) and a more integrated credit market. In the 1930s, the Bengal National Chamber of Commerce could be seen repeatedly pointing out the dangers of the drying up of the urban–rural credit networks. In the context of the Bengal Moneylender's Bill of 1933, the members showed concern that in the name of alleviating the debt burden on peasants, the government should not further discourage and destroy the rural moneylenders, given the general shrunken credit situation (Bengal National Chamber of Commerce 1933: 97). At the same time, the Chambers argued that even though loan offices and banks in the *mofussil* appeared to be going bankrupt, as agriculturalists defaulted in loan payments due to the depression, most of them were sound companies and should be transformed with the aid of the government into commercial banks (Memorandum to Government of Bengal 1933: 510). Unfortunately, the issue of reconstituting a different and fairer credit network was not addressed by the colonial government.

It is evident, therefore, that the early 20th century fragmentation was a product of the colonial nature of the money market as much as due to the pre-modern character of the financial system. In any case, the three Presidency banks and later the Imperial Bank functioned in a world of their own, as did the exchange banks—in thorough disjunction with Indian joint-stock banks and indigenous moneylenders. Although there was formally an inter-bank call market, it was not integrated. The colonial government initially was interested in banking only insofar as it could aid the functioning of the state's revenue and trading interests. Warren Hastings' short-lived experimentation with the General Bank of Bengal and Bihar, as early as the 1770s, was directed towards helping government remittances, stabilizing inland exchange, enforcing the Murshidabadi *sicca* as the standard coin of the provinces and curing the problems caused by the annual contraction of currency in circulation when the government mopped up huge sums of money as land revenue. The banking scheme proposed by Robert Rickard in Bombay in 1867–68 was merely an attempt at paying off the government's large public debt by transforming it into bank stock in the hands of the public (Reserve Bank of India 1970: 7–10). The government preserved the rights of note issue and functioned as a bank through its treasuries. If private agency houses set up banking concerns—just as Alexander & Co. set up the Bank of Hindustan around 1770, Mackintosh & Co. set up the Commercial Bank in 1819, Palmer & Co. set up the Calcutta Bank in 1824—they catered almost exclusively to Europeans and were anyway short-lived. The short-lived success of the Union Bank experiment of Dwarakanath Tagore clearly showed the legislative disadvantages with which banking as an enterprise itself had to function. Till as late as 1860, the scope of limited liability enterprise was not available to Indian companies; there was no company law till the mid-19th century and the government was reluctant to give charters of incorporation to indigenous banking firms (Tripathi and Mishra 1985: 13–15). When the Union Bank failed, the government failed to give it any support,[2] though when the Bank of Bombay became a victim of the 1864–65 cotton boom speculations, the government did intervene (ibid.: 15). Till the end of the 19th century, the growth of Indian joint-stock banking remained slow—primarily because of the currency crisis of the time and the endless tinkering by the colonial government with the Indian rupee. Fully preoccupied with the matters of currency standard and exchange, the government did not quite refer the question of banking either to the Indian Currency Committee (Fowler Committee), 1898, or to the Royal Commission of Finance and Currency (Chamberlain Commission), 1913 (Reserve Bank of India 1970: 19–20). It must also be remembered that unlike in Bombay, and to an extent Ahmedabad, where Parsi and Gujarati capital remained important right through to the 20th century, in Bengal the money market had become further fragmented by the end of the 19th century—precisely because European firms and industries had successfully and almost fully dispensed with the services of local, mostly Bengali *banias*, who had once collaborated and competed with the British as necessary and equal partners in the early part of the century (Bagchi 1997: 74–77).

To understand the history of banking in Bengal, therefore, we must situate it in this context—one, of currency uncertainty; two, of disrupted credit networks; and three, of colonial legislation (or the lack of it). In this context, or in spite of it, the *Swadeshi* movement inspired Indian joint-stock banking and insurance companies, though once again between 1913 and 1918 a number of bank failures undid much of the early 20th century spirit. Yet, until 1934–35, there was a fair increase in the number of banks, even though deposits did not show any huge net increase; in fact, deposits dropped in the 1920s, only to pick up later. The share of the Indian joint stock banks rose from about 31 per cent in 1930 to about 40 per cent in 1936, while the share of the Imperial Bank fell from 36 to 30 per cent. The share of exchange banks in the total deposits too, steady till about 1920, began to decline thereafter (Chandravarkar 1983: 782). The size and status of these Indian banks varied greatly, though in general they specialized in short- and medium-term credit and cash credits and overdrafts, rather than in bills. The Second World War saw a phenomenal growth, riding on the monetary expansion of the war effort, in banking—both in terms of resources and number of offices. The war saw a highly active money market, though not adequate channels for productive lending, with the result that a bulk of the increased bank deposits came to be invested in government securities and less in bills and advances or in industrial investment. Even then, since between 1939 and 1945, scheduled banks increased their demand deposits at a much faster rate than time deposits. Since the banks, therefore, did not have to pay too high an interest, the average interest from government securities allowed a minimal profit for the indigenous banking sector. The rise in the number of non-scheduled banks and smaller banks and the history of bank crashes that continued beyond Independence in 1947 was also interesting (Reserve Bank of India 1970: 65–66, 437–440).

But this entire story of the struggle of Indian banks in colonial Bengal would only make complete sense if written in terms of its social history. This, on the one hand, would be a history of Bengali identity, nationalism and caste/class negotiations. On the other hand, this would also be the story of the life of a so-called modern institution, brought in by colonialism, which the colonized had to and did make its own through various social, economic and political negotiations.

A Social History of Bengali *Udyog* and Money-making

Nineteenth century Bengali middle classes lamented the lack of *udyog* or enterprise among Bengalis. This was partly a critique of the colonial regime; partly, however, this loss of *udyog* was also invoked as a matter of self-critique. This was the middle classes' self-loathing for having become a nation of desk-bound clerks and absentee *zamindar*s in colonial times. The Bengali public now rested in idleness, having become money lending people and subsisting on interest. The government itself borrowed money from the public and the public remained happy at earning this minor interest on government securities (*Sambad Prabhakar* 1852: 88). Bengalis must realize that even land, let alone government bonds, was not a particularly viable or profitable investment and that there was no escape from the unfreedom of *chakuri* except by way of hard work, business and enterprise (*Sambad Prabhakar* 1853: 93). Interestingly, a newspaper such as *Sambad Prabhakar*, which always satirized the Bengali *babu*'s imitation of British mores, criticized Bengalis for not following the 'progressive' footsteps of English entrepreneurs in matters of business and industry. This was the time of shaping of Bengalis' clerical destiny, but also the time of the fairy-tale enterprise of people like Dwarakanath Tagore, who collaborated with the British even in indigo plantations and began the successful, though short-lived, Union Bank business. Bagchi (1972) has argued that the general failure of Bengali landed gentry to take to business was due to the peculiar economic policy of the colonial government that imposed indirect taxes on entry into the industrial sector. Contentious as the argument may be, it cannot be denied that English capitalism as practised in Bengal was a closed system.

It is significant that many of these and similar essays, which advised the Bengali nation to take up business in the place of *chakuri*, also critiqued the upper and middle caste Bengali's reluctance to work hard and deal with money matters. Prafulla Chandra Ray, for instance, tried to convince his contemporaries that 'Till, Tambuli, Subarnabanik, Vaishya, Saha communities' had indeed produced brighter minds, often more intellectually sophisticated people, than have Brahmins. He argued repeatedly that scientists like Meghnad Saha and Mahendralal Sarkar, and philosophers like Brajen Seal came from such traditional trading castes. Ray asserted over and over again that Bengalis could never imagine true freedom from foreign rule, unless they freed themselves from their caste prejudice against merchants (1936: 16, 21). Even while critiquing the *Swadeshi* movement for its romantic and ineffective invocation of nationalism for the sake of the market, Prafulla Chandra Ray formulated enterprise as a technique of nationalism, rather than vice versa. It must be remembered that this was also the time of movements for caste mobility in Bengal. Nirmal Kumar Bose has shown how some of the lower castes were demanding the same privileges as the upper castes like Brahmins and the right to engage in different occupations that they were hitherto not permitted (*Hindu Samajer Goron* 1949). Also, the upper castes like Brahmins took to small trades. Thus, the rigid mapping between castes and occupations was breaking down. The proverbial social profile and self-consciousness of the Calcutta *suvarnabanik*s can very well be the theme of a separate project. The *suvarnabanik*s, *gandhabanik*s and even *tili*s now articulated the significance of business and enterprise, not just as means of livelihood and/or productive practice but, above all, as nationalistic acts. This was not only an ideology of self-assertion as a group, of collective social mobility, but also a demand for a proper place in the four-fold *varna* system, often formulated as synonymous with the Hindu nation.

> The point in referring to the late 19th century mood is to distinguish it from the first half of the 20th century, where our story begins. With *Swadeshi*, the Bengali *bhadrolok* took to, at least tried to take to, business and industry with a different justification. To them, it was not a matter of caste or community mobility and tradition, but a matter of marrying individual enterprise, education and science with money matters.[3] This *bhadrolok* interest in enterprise and the merchant community's interest in education, however, must not be interpreted as merely an ideological shift, which

> brought business back into the mainstream discourse of nationalism *contra* the late 19th century where business was a caste or community matter. This was also a material shift in the technology of socio-economic mobilization, which had much to do with the Bengali middle-class' financial destiny (Banerjee 2001).

The mission was to embark on life adventures based on rational thinking and analysis, where innovative and progressive ideals were to be married to Weberian virtues of thrift, hard work and specialization. This split was already visible in the late 19th century, when many of the upper castes began leaving their localities and arriving in Calcutta for English education and new employment opportunities.

Independent professionals like lawyers, doctors and engineers, on one hand, and social leaders like *zamindar*s and school teachers, on the other hand, had the highest incentive to start a business that could be linked with, and therefore get the support from, the *Swadeshi* movement (Banerjee 2001).

> P. C. Ray of the Bengal Chemicals was a teacher of chemistry and an experimental scientist, as was Jogesh Chandra Ghosh of Sadhana Aushadhalay; Ramesh Sen who set up a factory for making socks and vests in Mymensingh was a lawyer; the Pabna Silpa Sanjibani, a hosiery factory, was founded by a *zamindar*, Taran Gobinda Chaudhuri; the Pioneer Iron Works was founded by a doctor Mahendranath Nandi, as was the National Tannery of Nilratan Sarkar; Mathura Mohan Chakravarty of Sakti Aushadhalay was a high school headmaster from Dacca. Some of the factories also conducted original research in order to make weaving, woodcutting and other machines. Not entirely was this tradition of entrepreneurship non-viable, Bhattacharya (1995) shows, for works like Bangalakshmi Cotton Mills, Bengal Chemicals, Gopal Hosiery and others showed remarkable staying power. The point was to recognize that the expansion of Chettiars in Malaya or the Birlas in Burma or the success of Tata Iron and Steel Company (TISCO) was also a result of partial patronage by the colonial government, something these Bengali business houses could not garner because of the political discourse on which they depended for the creation of their own market in Bengal (Bhattacharya 1995: 239–47).

It is in this context that we must analyze our story of banking—a context of socio-economic practice and political-economic discourse which sought to recreate the financial base of the Bengal economy as synonymous with the Bengali nation.

Banking: The Reconstruction and Socialization of a Colonial Institution

In the countryside, cultivators needed loans for financing consumption, input purchase and marketing. The small cultivators also needed capital at reasonable rates of interest that would free them of the stranglehold of the usurious moneylenders. Post offices and cooperative societies offered savings schemes at moderate rates of interest but were inadequate as far as meeting the credit needs of the rural society was concerned. In particular, these institutions did not serve to get the small cultivators freed from the debt trap of the usurious moneylenders. Despite the clear demand for an institution like indigenous banking in rural Bengal, some supply-side factors had to be satisfied before they would begin to emerge in adequate numbers. The first condition was availability of financial capital to set up such institutions. Only individuals with enough investible resources like lawyers, traders, doctors, and so on, could enter as banking entrepreneurs. Second, even with enough investible capital, these individuals had to be skilled in banking operations of certain types if their organizations were to survive and make profits. It was never easy to do banking business for the *mofussil*. In fact, despite the lack of easy credit sources, it was always a problem to find enough borrowers; and deposits had to be collected by exercising personal contacts (Dutt 1994: 31). Also, the cheque habit was yet to be developed; bankers, in fact, campaigned for the inclusion of political economy primers as compulsory reading in matriculation courses (Dutt 1930: 544). When Ananda Kishore Datta Ray established the Brahmanberia Loan Co. in 1901 in the area, so unfamiliar were the locals to the idea that shareholders had to be invited from as far as Rangpur (Dutt 1930: 87). Even though banks were particularly numerous in eastern and northern Bengal, there were limits to the nature of banking they could practice. The *mofussil* banks did not get the benefit of the share market and of the marketable government and other securities in case of immediate liquidity needs, so they feared to invest their resources profitably (Dutt 1930: 85). Also, as J.C. Das, banker and auditor and the founder of the Bengal Central Bank, said in 1927, such banks had to loan money primarily to individuals from the middle classes on personal credit, to *zamindar*s and *talukdar*s on land mortgages, and to lawyers and their clients for trial expenses. None of this constituted productive loans. Even the credit for trade and movement of goods was still controlled largely by Marwaris. Since the banks had to accept mortgages as collateral for credit, a large part of the banks' liquidity remained frozen in assets. Especially since, unlike the Marwaris' financing trade, such banks gave long-term loans. Banks thus turned out to be like unproductive *zamindar*s in the *mofussil*. Also, the control that lawyers had on banks meant that while banks locked in their resources in assets, mortgage trials remained a profitable business for lawyers who encouraged such freezing of the liquidity of the banks. J. C. Das argued that if not industrialists, at least traders should be encouraged into banking; but since banks had not been able to introduce any new kinds of commercial papers, new kinds of securities were lacking on which credit could be had (1927: 127–30). The preference for mortgages was also mentioned by Prakashchandra Basu, who said that businessmen in general accepted that except for mortgage business, nothing else in the world could generate unrisked and sure profits (1951: 61). It was also well-known that even though the banks did have enough capital to finance industry, they refused to take the risk of lending for very long-term without at least partial government guarantee. The colonial government, of course, refused any protection to the banking sector; in fact, there was no banking legislation beyond a general company's act. The result was that banks would loan out money largely for trade and thus became vulnerable to even short-term speculative activities (Ittikhar 1982: 117). The fact that indigenous banking companies emerged despite these high transaction costs of business was due to two factors—one, their exclusion from the urban market controlled by the British enterprise system; and two, the tremendous resentment in the countryside against the moneylender class, which not only created an economic demand for these institutions but also a socio-political demand.[4] Apart from this, some of the general economic conditions in the countryside were facilitating factors, like the increasing demand for raw jute spurred by the boom in the jute industry. This led to an investible surplus for the jute cultivators and traders, which would increase the potential[5] deposit base of the indigenous banks as well as increase the potential demand for loans from these banks to finance the expansion of jute cultivation. There was also an increasing demand for cotton weavers due to the import of cotton piece goods from Lancashire. With the rise in income of cultivators, an increasing proportion of them would be free of the debt trap of usurers, the countryside became more monetized and the scope of banking operations increased all round.

It is in this context that the story of small *mofussil* banks began.[6] Prafulla Chandra Ray's father came from a *zamindari* background and remembered that they were once *jagirdar*s of the Mughals in eastern Bengal, they still had *badshahi* coins to prove it. But in the 19th century, he was already convinced that locking up money in land and ornaments was foolish because it brought no incremental return. Ray's father also knew the problem of not having modern institutions like banks, for his ancestors had left all their treasures buried in the walls of their house, which, despite much digging here and there could never be recovered. He, therefore, had no qualms in selling his wife's ornaments and reinvesting the money in more profitable ways. He also began the first loan office in the area. The village people, with too small a saving to invest themselves, yet too important to lose them to theft, took to this loan office with great alacrity. This also brought in a lot of liquidity in his hand. Ray remembered how his father later suffered from a failure of this loan office, yet he kept the trust of all his depositors, at great cost to his own solvency. Inspired by his father and the rags-to-riches stories of people like Benjamin Franklin, who had taught the world that time was money, P.C. Ray himself could never rest easy with the life of an intellectual and propagated life-long the virtue of hard work and enterprise (1961: 10–11, 25). Bata Krishna Dutt (hereafter B. K. Dutt), the main protagonist of our story of the United Bank of India (UBI), knew Acharya Prafulla Chandra Ray, who had taken him around to show the site of Bengal Chemicals when he was a young man, and in a way they both belonged to the same social process which marked early 20th century Bengal.

Somewhat, but not very, different was the story of the Ray family of Bhagyakul, also in eastern Bengal. This family too began with a *zamindari* social base in the Dacca district, which initially financed social and educational charity in eastern Bengal, later held a political position in Calcutta and finally in 1940, Jadunath Ray established the United Industrial Bank. Apart from these well-known banks, numerous small indigenous banks (or loan offices as they were more popularly known) were started as early as the 1860s and 1870s, like Faridpur Loan Office (1865), Tripura Loan Office (1871), Barisal Loan Office (1873), Bagura Loan Office (1874), Nasirabad (Mymensingh) Loan Office (1875), and so on. But most of these early banks or loan offices were on experimental basis and with very little calculation about their economic feasibility, and as such had limited viability in the medium and long run. Only about two dozen of them could last until 1930 and after. Some of them are listed in Table 1.1. Usually the main causes of survival have been attributed to the credibility of these institutions in the eyes of the depositors and investors, foresight in terms of anticipation of difficulties and making early provisions and safeguards against them, modern views and practices, and support and trust of the people, industrialists, and so on. It can thus be surmised that though there was considerable demand for indigenous banks, the successful transformation of that demand into successful operation was subject to heavy transaction costs, significant operational constraints and the vicissitudes of the market.

Table 1.1 Some survivors till 1930

Name	*Date of Establishment*
Jashahar Loan Office	1876
Jalpaiguri Banking and Trading Corporation	1887
Khulna Loan Company	1887
Rangpur Loan Office	1894
Bhabanipore Banking Corporation	1896
North Bengal Bank	1903

Source: *Bartir Pathe Bangali*—Benoy Kumar Sarkar.

Apart from the obvious demand for indigenous banks in the rural and semi-urban areas, there was also a serious perceived demand for such banks in the urban areas. The cities were the focal points of *Swadeshi* and there was significant human capital and knowledge base that could be used to harness the spirit of nationalism through *Swadeshi* enterprise. The leaders in such enterprise had some ability and resources to provide seed financial capital but they also needed finance from external sources to complement their own capital. Unfortunately, by the end of the 19th century, Bengali business had become painfully conscious that the most important constraint imposed on *Swadeshi* enterprise was that of external finance—neither the European banks nor the *deshi* Marwari[7] banks catered to the needs of indigenous entrepreneurs in Bengal. The finance from local loan offices and indigenous banks was often inadequate. To some progressive thinkers and entrepreneurs, the situation was ripe for major forays into financial business. Indeed, by 1907–08, the emphasis of nationalist enterprise in Bengal had shifted from industrial production to that of commercial services like banking and insurance. *Swadeshi* banks were seen as necessary and sufficient conditions for integrating the money and credit markets of rural and urban areas, and thus led to greater and easy access to finance for all sections of the population. The urban banks therefore had to branch out and make profits while meeting such an important social responsibility. At the same time, rural banks were also urged to branch out in urban areas, and the two institutions were seen as complements that needed cooperation from each other.

Financial writers and press play an important part in the development of financial institutions, and Bengal was no exception. Seshadri, writing the history of the Indian Bank, remarks that even though *Swadeshi* inspired many indigenous banks in the south, including some large banking houses, the scene was nothing like the amazing proliferation of small banking enterprises that happened in Bengal (1982). Banking had caught the imagination of Bengali middle classes by the middle of the 19th century. An article in *Amritabazaar Patrika* in 1865 said that while it did not see much point in large government-run savings banks in Bengal, Bengalis should endure that the people of each locality get together with small savings and set up small banks in the countryside. That could be profitable business for the initiators and at the same time would help the ordinary rural population tortured by usurious moneylenders. It also categorically said that it would not be right to ask the government for banking facilities, for it had to be something that people did by themselves (Bagal 1869). In the 20th century, *Kamala*, a monthly magazine about 'agriculture, commerce, trade and science', began with the understanding that in a poor country, small savings were the clue to prosperity (1903). An advertisement by the Hindustan Co-operative Insurance Society openly admitted that *Swadeshi* would remain an elusive ideal so long as Bengalis, though capable, remained entangled in their individual, familial anxieties and obligations. Insurance was expected to free this money and manpower which remained tied down in such petty worries (*Kamala*: 224). *Kamala* also propagated small savings and advertised insurance on the ground that 'saving is a primary practice of civilized societies' (1903). It also acknowledged that no individual in modern times could face the vagaries of the market on the basis of his own individual savings—so some must go forward to start the business of banks and surely many others would follow. The magazine advertised a 'Kayastha' bank started in Gorakhpur and advised its readers to start many similar small banks by themselves (1903: 481, 490). *Arthik Unnati* published essays by someone writing under the acronym '*bank gabeshak*', who argued that the old tradition of trading on the basis of one's own capital was irrelevant today; neither was this a time of extensive personal networks which inspired partnerships and family businesses. This was a time when business depended singularly on one's credibility before the *mahajan*. This 'trust or credit was the true foundation of modern enterprise' and hence banks were the primary indicator of the times (1927). Even as late as 1946, such enterprises tried to promote savings by articulating a sense of a national lifestyle that would involve self-control, circumspection and foresight as almost moral traits. This moral-political slant was not just a pretext for propaganda or advertisement. It represented a mode or technique of resource mobilization that presumed that the primary economic act was that of instituting a general social process by which isolated and besieged individuals could come together and bring their small savings into a collective, national pool. Otherwise, individual domestic life was doomed, for society no longer offered other traditional kinds of community or familial cushioning, or neighbourly or caste reciprocity. The necessary condition for the pooling of resources was the emergence of domestic financial institutions, which would be able to command trust by arising from a pattern of economic specialization that was based on the strength of such primitives as talents, resources and social capital in finance. The language of this business could no longer remain exclusive or technical. Practices of banking and rational sensibilities of credit had to be popularized. Narendranath Ray's remarkable book on money argued that Bengalis must neither use English nor search Sanskrit *abhidhan*s to find the requisite political economic jargon. In fact, they should harness current local usages through which economists and entrepreneurs could interact with the ordinary man in the villages.

Thus, he argued that the word 'credit' already had an equivalent in the chaste Bengali usage *pasar*, calling it '*bazar sambhram*'; even 'credit' itself would only reify and defamiliarize its meaning (1926). *It was thus in the form of a social process that banking had to be instituted in 20th century Bengal and only as a social process could it compensate, to an extent, the problem of lack of capital in a colonized society excluded from its own resources.*

The most passionate and interesting formulations about banking came from sociologist and philosopher Benoy Kumar Sarkar:

> National life, daily life, spirituality—bank is an immense machine that measures these things.... A nation which does not have a bank must be understood as a nation whose men and women do not trust each other. People of such a nation can neither believe anybody nor are trustworthy themselves.... A nation which lacks trustworthiness in matters of money exchange is a nation whose spirituality is on the decline (1927: 624).

As an institution of trust, Sarkar realized, banking was founded upon the principle of liquidity provision. He, therefore, argued that the champions of the cause of the indigenous banking industry should carefully track the paid up capital to deposits ratio, reserves to deposits ratio, and the advances to deposit ratio. In his analysis in *Bartir Pathe Bangali* (1935), he ranked banks in terms of paid up capital, deposits and advances (for the interested readers these are summarized in Appendix 1.1, 1.2 and 1.3). Sarkar argued that the numerous loan offices, which were scattered all over Bengal, were themselves amenable to be transformed into banks or centres of mutual credibility and friendship. This had the agenda of young India, if the nation had to bypass its colonial setback. If there were no longer big business houses or large merchant capital in Bengal, it needed to bring together the resources of the ordinary householders into a concentrated capital fund (1927: 630). In fact, as late as 1933, the Bengal National Chamber of Commerce campaigned, in context of the government's proposed Reserve Bank Bill, that the numerous indigenous loan offices be given the opportunity to enrol as scheduled banks if they satisfied minimum conditions, for therein lay the real capital resources of Bengal (1933: 515–41). The magazine *Kajer Lok* thus serialized essays on the *rahasya* of the thing called banking—that not only explained the structure, functions and rules of banks, assessed the administration and reliability of individual banks, analyzed business terminologies such as 'speculation', 'investment', and so on, in easy Bengali, but also proclaimed that 'amongst all kinds of profitable business, banking or *mahajani* business is the highest' (1909: 3). N.L. Ray & Co. began publishing a monthly magazine called the *Share Market*, which apart from publishing the prices of *company kagaz* of government securities, also published the share prices of banking and insurance companies. *Arthik Unnati* advised its readers to get familiar with the idea of stocks and shares and such published lists, and pointed out that the shares of even some Bengali banks were being bought at a premium (1926–27). The numerous business magazines that started in the first half of the 20th century in Bengal regularly published news stories about the small banking experiments by Bengalis. Thus, *Arthik Unnati* wrote in 1926–27:

> Like in other districts, a bank has been set up in Chittagong as well. We find both Hindu and Muslim names in the list of shareholders and managers. It is being supervised by local gentlemen with experience in trade and industry. If you move money between Bengal and Burma, help is available from this bank'.

Part II: Some Financial Entrepreneurs

In this part, we trace the evolution of the constituent units of UBI up to the event of the merger which led to the formation of the bank. In doing so, we uncover the process through which some of the hidden entrepreneurial spirit and talents among the Bengalis got shape in finance.

In the context of developing economies, the banking system has historically played a bigger and a more fundamental part than the capital markets in financing industrialization. In the early stages, it was a combination of the government and the banking system, and it is generally recognized now that that the latter has certain advantages in this task.[8] In this context, the banker with market power plays a special role. He chooses the degree of risk-taking in the industrial economy, the smoothing of income in risky agriculture and provides local savers with liquid securities. In each important geographical zone, the banker with market power is required so that he can take risks in finance with adequate safety cushion, and lubricate the wheel of industry and commerce. This market power directly primarily derives from some protection that the financial and monetary authorities bestow on the banking sector (for maintaining stability in the financial sector and to sustain the power- and rent-seeking structure of the modern industrial economy). Two other important reasons are the presence of increasing returns in banking and the asymmetric structure of information in the credit market. However, despite the presence of market power, one must concede that without the ability of the banker to guide his bank through initial birth pangs and inherently risky path of its youth and finally to stabilizing its growth in maturity, one would hardly see banks making their mark over time. Such a role played by the captains of the financial industry is a necessary condition for significant growth in trade and production, let alone innovation and technological progress in industry. If the captains cannot play this role, it would completely shut down the scope of development of industry and markets in a poor economy. This special entrepreneurial talent in finance has often been neglected by the development literature, and it is time to integrate the experience of economic history with the theory of economic development and the theory of financial intermediation to rectify this sad oversight. In this section, we are going take this interdisciplinary path to study an entrepreneurial banker emerging in eastern India a few decades before Independence and study the dynamics of the story. Before we embark on that ambitious path, one must reflect a little on the nature of entrepreneurship.

Market conditions always leave room for the talented entrepreneur to exploit and even change them at times. The question is whether the entrepreneurial skill is present and what the preconditions for its successful exploitation are. The acute scarcity of this particular type of skill (as witnessed by the high degree frequency of failures of start-ups in any industry), with respect to its demand and the randomness of its success attributes, makes it difficult to construct a theory of entrepreneurial behaviour. To the extent wealth, attitude and talent permits, some people will be entrepreneurs and there is not much to theorize beyond that (given that the firm has a distinct legal as well as economic identity of its own, it is not to be equated with the entrepreneur). In other words, one cannot write a textbook on how to be a successful entrepreneur as one could write a theory of optimal managerial behaviour in textbook form. The primary difficulty lies in the fact that entrepreneurship is an art that has multidimensional behavioural requirements and complex dynamics involved in its implementation and planning, which no single academic discipline can handle alone. It is a talent at the end of the day and you either have it or do not. However, one can at least lay down the conditions under which the probability of entrepreneurial experiments may increase at certain stages of socio-economic developments and the conditions under which such experiments may produce a critical mass of successful and active entrepreneurs with significant impact on technological innovation, growth, trade and risk bearing. Historians have long recognized that social and intellectual revolution, political protection and economic freedom typically throw up a number of entrepreneurs as does the influence of family business or education. Given these conditions, the (potential) entrepreneur looks at a product, market and industry and asks, 'Is there another, more efficient way of doing things here?' The ability to ask a provocative question is positively correlated with the capability to answer it and implement the solution in practice. The purpose of this section is to see a financial entrepreneur from this point of view while keeping in mind the challenges faced in financial entrepreneurship at a critical stage of development of the Indian economy.

Father and Son: Comilla Banking Corporation Ltd and New Standard Bank

Bata Krishna Dutt was born in Comilla (now in Bangladesh) in 1910. The village in which his ancestors lived for years was called 'Kalikatcha', about seven miles from the town of Brahmenberia subdivision of Comilla district, which was then called 'Trippera' district. Comilla was a town of 'banks and tanks' that produced several well-known financial entrepreneurs, writers, poets, musicians and actors. Great men like Tagore, Gandhi, C.R. Das, Subhash Chandra Bose and many other leaders had addressed meetings there. It was also a place for political activists. Dutt acknowledged the important influence these factors had on his early life.

But the biggest influence on B. K. Dutt was that of his father, Sri Narendra Chandra Dutt. Narendra's father had died when he was only nine months old and he was deprived of his rightful inheritance since there was no written will. Narendra's mother brought up the child in strained circumstances. He had to walk a long distance everyday to attend school. Later, he went to Calcutta where he lived precariously for his Bachelors degree in Law. He married when he was studying law and on completion of his education, he went with his family to Comilla to start practice. Success came quite early and he soon built a house for himself from his earnings. He was recognized as a man of integrity, fearless, self-sacrificing, patriotic and charitably disposed. These qualities moulded the character of most of his children, of whom B.K. Dutt was the eldest. Though his law practice continued to flourish over time, Narendra would remain a man of simple habits and plain living. Apart from his moral qualities, he had the intellect and the energy in him to start a business enterprise. In those days, lawyers were at the forefront of social service and political activity. Narendra Chandra acted as a facilitator in the field of cooperative banking and took great pains to establish rural cooperative credit societies. He spent his weekends going about in horse-drawn hackneyed carriages to nurture these societies (which he gave up only in 1914 probably due to differences of opinion as to operating methods and lack of integrity on the part of those concerned). He had his own ideas formed about finance by that time and this, coupled with his desire to use the business of finance for providing relief to the needy, agriculturists and others, led him to set up his own bank. His bank,[9] Comilla Banking Corporation Limited, began in a shed with an earthen floor, tin roof and bamboo walls. The first seat was a lawyer's *gaddi* (chamber), the lawyer working from the desk both for his legal clients and for the bank's customers. The cash box would be sent after the day's transactions to be locked in a safe at Mahesh Bhattacharjee next door and returned from there next morning. In the early days, the bank used to work in two shifts. At that time, it had a capital of only Rs 3,000 and only one clerk (Bipin Dutt, who was also Narendra's legal clerk). Although being a successful lawyer, he gave up his practice at the Bar when he started the Comilla Banking Corporation in 1914. As B.K. Dutt reminisces, 'I thus grew up in an atmosphere of banking from the age of four' (1994). Comilla and Brahmenberia at that time had a number of small entrepreneurial banks and loan companies. The founders of most of these institutions, like N.C. Dutta, were believers in plain living and high thinking, and motivated by socio-economic concerns. Thus, the idea of social banking was instilled in B. K. Dutt at an early age quite naturally and enabled him to rise over the narrow concerns of profit maximization in business in the times to come. In his personal life, attention was given to cultivating good manners and be satisfied with basic amenities of life and not be demonstrative—a set of inbuilt ethos very different from that of the modern Western and westernized society. This combined with an entrepreneurial culture created a man who, together with his institution, would find universal acceptability in a society that believed in ethics even in the domain of economics. Brahmenberia was a business centre with a railway station, a court, headquarters of several loan companies and *zamindars*. The residents were highly educated and progressive in their outlook and friendly in their manners; it was a small world where everyone knew everyone and if one had credibility, establishing a business was not a frightening prospect.

N. C. Dutta was well known in Brahmenberia. At Brahmenberia, Govindalal Dutta, a friend of N. C. Dutta, was the head of a loan company which later merged with the Comilla Banking Corporation. N. C. Dutta had two uncles living there—Pratap Dutta, the lawyer, and Jogesh Dutta. Everytime B. K. Dutt accompanied his father to Brahmenberia, they would stay at either one's house.

B. K. Dutt was also inspired by the life at his ancestral home village where he would form a healthy and positive outlook about life and people. The people in the village of Kalikatcha were friendly and intelligent, with a fine sense of humour. The village had given birth to many eminent people. Among them was Dwijadas Dutta, whose son Ullaskar Dutta was a great revolutionary. There were some 'Brahmos' who were the avant-gardes in the realm of progressive thought and education. Among them was Mahendra Nandi, an eminent physician.

The evolution of the Comilla Banking Corporation was carefully observed by B. K. Dutt and he learnt important lessons in a craft which he would later refine and extend. In those days, particularly in the late 1930s, the real problem in banking lay in finding worthwhile borrowers rather than depositors. Many who really needed money could not think of approaching a bank. Therefore, special efforts were to be made to find out borrowers who would repay and convince them of the importance of bank finance, especially when a viable project was constrained by lack of funds. On the liabilities side, money was offered as deposits by personal contacts, but for a bank of Comilla's size, they were mostly fixed and savings deposits since the bank's assets were mostly illiquid and turnover was yet to reach a certain critical mass so as to enable the bank to provide liquidity insurance to depositors (Diamond and Dybig 1983: 401–419). For the bigger banks however, the trend was towards demand deposits, which were more liquid and safer. Demand deposits became especially popular during the wartime booms. As B. K. Dutt astutely noted, the rise of demand deposits led to a major departure in the lending programmes of bigger banks, which had repercussions on the operations of medium and smaller banks. The Comilla Banking Corporation dealt with the emerging challenges with skill and imagination and won the depositors' trust while maintaining the tradition of being the friend of the needy man. Efforts were made to find new borrowers in the *mofussil* areas and the city of Calcutta, and the bank became the main support of the small-scale industrial concerns, the one man or one family production units, manufacturing small consumer items of daily use for the common man.

These activities naturally expanded with the growth of the bank's business in Calcutta. The bank's first Calcutta branch at 12/2 Clive Road was under the control of B. C. Ghosh (B.Sc. Eco. [London]) who later became a member of Parliament. Ghosh was succeeded by Harish Chandra Sarkar, (B.Com. [London]). Both came from well-known families of Dhaka and besides a good education, Sarkar had behind him considerable experience in insurance business. In those days, the two criteria that mattered were family and education. Then there was Sudhir Chandra Nag, (M.A., B.L.), who later succeeded Harish Sarkar. Each of them was a person of dedication and integrity, and was persuaded to join the bank on a very nominal emolument. But this did not come in their way of discharging their duties with zeal and enthusiasm. Harish Sarkar was also responsible for extending branches of Comilla Banking Corporation to places like Kanpur, Lucknow and Delhi. However, B. K. Dutt observes:

> He was irrationally ambitious and suffered from the complex that one day he might have to work under me as a manager and so he left the Comilla

> Banking Corporation Limited to join the first United Commercial Bank Limited and then the Calcutta National Bank Limited. I acknowledge his role in laying the foundation for growth of the bank (1994: 32).

When Sarkar left, Sudhir Chandra Nag succeeded him and it was he who built up and expanded the business of the Dhaka branches. He was with the bank throughout and retired some time after the birth of the UBI.

The bank's building at Comilla, the first one built by N. C. Dutta, was completed in 1930.

> It was a replica of a bank building abroad and was a two storeyed building with 12 feet wide stairs rising from ground level to the first level, each step having a marble—12 feet long. The space in front of the counters was also a lid with marbles. The doors and windows were large and panelled with glass. There was a Gandhi plaque in concrete. What was amazing was that the strong room had no more protection than safes. The safes were visible to the public through the glass windows. Indeed, it was an extraordinary building. Soon after, the building was blessed by the blood of the Swadeshi volunteers when it was converted into a hospital for the injured processionists who broke section 144 imposed by the British Government (1994: 32).

Narendra was also instrumental in the construction of the building for the bank at Number 4 Clive Ghat Street, in the Dalhousie area of Calcutta in 1937 (the street is now known as Narendra Chandra Dutta Sarani). It had 35,000 sq ft floor space made of concrete, with two lifts and all utilities, which cost Rs 325,000. He had visualized that the bank, in the near future, would require larger space than the hired space it had. It was on a leasehold plot of a land. Later on, he built for the bank the only building with an elevator in Dhaka. It was an impressive building and earned public confidence.

After completing his studies and on return to Comilla, B. K. Dutt joined the bank to work as a trainee. Soon his responsibilities expanded and he was entrusted with the job of garnering of deposits and canvassing for borrowers. One of the unpleasant assignments given to him was the work relating to litigation in Calcutta High Court in defaulting cases. The first one concerned a group of revolutionary young men. They were Atin, Jogesh Chatterjee, Prafulla Chakraborty and Probodh Chakraborty. Earlier they had found an engineering shop in Comilla, financially backed by the great nationalist Mahesh Bhattacharjee, purely on ideological considerations. But he insisted on both performance and financial auditing of the books. But the revolutionaries did not like it although they were innovative and hard working. Soon they paid off Mahesh Chandra by borrowing from Comilla Banking Corporation (one of the first refinancing schemes handled by the bank). However, the account was out of order and they turned to I. B. Dutt of Comilla Union Bank without paying off Comilla Banking Corporation. B. K. Dutt approached the solicitors firm Fowler and Company. Soon the company was wound up and reconstructed.

Another case which hardened B. K. Dutt and took him closer to the precarious world of business was that of Saraj Ghosh who had obtained money from the bank against false military bills from various parties, including banks. In order to be certain, the bank sent Sudhir Chandra Nag to Fort William, Calcutta, to obtain counter signatures of the military officers concerned on the bills to be sent against. A gentleman of high rank dressed in uniform was sitting in the room and he countersigned the bills. Then one day Saraj Ghosh came to B. K. Dutt and said

> My insolvency will be known to the public and creditors in a week's time. Your father and you have treated me well. So I would like to secure the bank's loan and I hand over to you all my title deeds shares etc. Please get the documents executed without delay: the military bills are all false.

In a great hurry the documents were completed and the bank's money was saved.

But the most important training B. K. Dutt received was in deposit mobilization and credit control. To increase pressure in this regard, Narendra always contracted to purchase government securities by borrowing a couple of days before he departed for his periodic visits to Comilla. The employees had to struggle hard to liquidate the borrowings soonest. This ensured fast growth. Among the few things concerning the bank's operations which B. K. Dutt learned from his father was that he would tell the bank officers, 'You are experts in telling me why a loan proposal cannot be sanctioned. But could you not find out as to how it could be made possible?' In one case when he was sitting in the room next to that of the Calcutta manager, he overheard discussions between the manager and a prospective client. When the manager rejected the client's request for a lower rate of interest, he intervened and accepted the rate. Later he remarked that one who fought for a lower rate of interest was more likely to pay back than one who really agreed to pay a higher rate of interest. This seems remarkably relevant in context of contemporaneous discussion on adverse selection (Stiglitz and Weiss 1981: 393–410) and moral hazard (Diamond 1991: 393–414) in credit markets.

A few years after starting the commercial bank, Narendra Chandra had turned to his love of agriculture, especially the plantation of tea. He began tea planting in Mantala tea estate in the Tripura around 1919. By 1935, around 5,000 acres had been brought under cultivation. Narendra had originally used cheap seeds on expert advice and all the plants were cut back at 12/18 inches as usual, to get the due spread. But there was a very high rate of mortality, causing serious trouble. Most of the bushes had to be replaced by good seed plants. The factory itself had a good shed, but the machinery, including the steam engine, was old. It was a portable steam engine carried from Comilla by train and pulled through eight miles on a rustic road. Water was also scarce. Originally, Narendra's bank did not finance the tea company. The company had a managing agency with big names as partners. Later the managing agency was surrendered and Narendra took over as the managing director.

On his return from Calcutta after his studies, it fell upon B. K. Dutt to take some care of the tea estate also. The years 1930–32 were a bad period for the banks, tea estates and the economy in general. The world depression was on. The bank and the tea company were under severe financial strain, but Narendra was steady and watchful. He would take some cash out of his own pocket and sit in the bank to meet any urgent demand of his depositors, or for the business of Mantala Tea Company.

To save the tea industry, an export quota system was evolved. Quotas, however small, were allotted to all tea estates, whether they exported any tea directly or not. But the statutory changes made in British India for the export quota system did not apply to Tripura as it was a 'native state'. B. K. Dutt was instructed to get the necessary orders issued by the Maharaja of Tripura. After a prolonged ordeal, the order was obtained.

At Mantala, B. K. Dutt had to go through all the phases of tea planting, production, management, finance and marketing. The company had a large number of small depositors. In a few years, all the deposits were paid off. Later on, Narendra acquired some more tea gardens and this resulted in a further build up of expertise of the family in tea.

Comilla Banking Corporation financed tea estates. In B. K. Dutt's case, the New Standard Bank first financed a tea estate in Sylhet. Tea financing by the family started from the very first stage of the first pruning operations because of the technical expertise that they had already acquired. Purchases of tea gardens were also freely financed by the Dutts. Advances of New Standard Bank went down because of the war against substantial deposits growth, thus lowering profits to substantial levels. The Dutts were hard-pressed to look for some profitable advancing. They kept their ears open regarding whatever was going on within the market for tea gardens. Soon an opportunity came their way. They learned that P. C. Shyam, a person from Sylhet with very nominal experience in tea and no risk capital to provide, had contracted to purchase Tonganagoan Tea Estate and two other tea estates from McLeod & Company of Calcutta. B. K. Dutt went to Sylhet with a proposal to lend him the required funds for the buyout and working capital, conditional on a large commission on sale of tea, which had come into vogue at that time. After some heavy bargaining over the contractual provisions, an agreement was reached and the bank was able to utilize its surplus deposits in an efficient manner.

Within a few weeks after B. K. Dutt's joining Comilla Banking Corporation, Narendra told him that if he did not like to work with his bank, he could have a bank of his own and prove that he could make it. It was clear that Narendra had confidence in the ability of his son and wanted him to be as independent as he himself was when he started Comilla Banking Corporation. For his son, this was a great opportunity and the latent desire to be an entrepreneur surfaced in him quickly. He agreed to the proposal. Narendra had another company, the Comilla Rice and Oil Mills Limited (one of his excursions in agro-business) which had ceased functioning. This company, which had a net worth of about Rs 30,000 was converted into a bank and was handed over to B. K. Dutt. After some legal and technical difficulties, the name was changed to New Standard Bank Limited.

The Head Office of the New Standard Bank was located in a secure *pucca* garage of a neighbour and friend, Mahesh Bhattacharjee. Between eight and 10 in the morning, the Bank would finish its office work in the garage and then Dutt and his co-workers would travel around on their bicycles, as a veritable mobile bank. They would then set up a shop on the balcony of the Bar-library at the district court, servicing the financial transactions of the numerous lawyers, clients, peasants, *jotedar*s and *talukdar*s who would regularly visit the court from all over the district. Just across the road was Comilla Banking Corporation. The father and his bank were on the west side of the road and his son's bank on the east, one facing the another. But Narendra was officially involved in his son's bank. His 'N. C. Dutta & Sons' was the managing agent of New Standard Bank. In those days, a group of persons could form a partnership firm or a joint stock company to run one or more companies as managing agents. That was how British Houses conducted their business.[10]

In those early days, B. K. Dutt could only afford a part-time clerk and a part-time *chaprasi* to assist him, and a cycle to move around. From the same garage, Saraj *babu* and Shamacharan, both from Mantala Tea Company Limited (a company managed by father), were also functioning. Nagen Gupta came in later. B. K. Dutta had to pass various tests before he could actually establish credibility as a banker. The 'would be clients' would ask various questions such as 'What is a bank? Why should one put one's money in the bank?' Some would even test the bank by drawing out money soon after depositing it. Though B. K. Dutt enjoyed the affection of everybody in Comilla town, being the son of Narendra, door-to-door canvassing often made him unwelcome. Both share capital and deposits were needed. Only his elders had the money. They were hard nuts to crack, particularly when his competitors were stalwarts like Narendra and I. B. Dutta of Comilla Union Bank Limited. The first depositor of the New Standard Bank Ltd was Haren Mukhtiar and the first subscriber to the new issue of shares was Rajani Ghosh, a sub-judge at Sylhet.

Apart from organizing the New Standard Bank Ltd, B. K. Dutt took up the agency of Mohan Lal Mukherjee & Sons of Calcutta to sell their tea chests imported from Finland, on a commission basis. At the end of 12 months, he got a cheque for Rs 1,500 as the commission, a very substantial amount of money. When Narendra heard of this, he told his son, 'Either you are a banker on Rs 250 per year or a commission agent for selling tea chests. You cannot do both at the same time.' So B. K. Dutt had to give up his lucrative agency. In his words, 'My destiny ruled to make me a "so called banker".'

As its capital increased gradually, the New Standard Bank also included tea estates in the list of its customers. The first advance was of Rs 10,000 given to Maulavi Abdur Rashid of Sylhet for his estate Dilkhush (Dutt 1994: 115). The first branch office of the bank was opened when, with the indulgence of the district judge in the Civil Court compound at Comilla, a shed was built with all the formalities complied with. Next, a branch was opened in Silchar (Cachar district of Assam, then in Sylhet) and Shillong, and soon expanded to other tea areas like Jorhat, Tinsukia, and so on (Dutt 1994: 39). This was a time when the depression was wreaking havoc on the tea industry and, unlike the larger European firms, Indian planters did not have easily available sources of finance. The Imperial Bank ordinarily did not finance capital and block expenditure, but only hypothecated crops (Report 1930: 42). There were indeed rumours around 1930 in Jalpaiguri and Calcutta that large Calcutta banks had come to a mutual understanding not to help any *mofussil* banks which financed the tea industry.[11] It was in this context that banks like that of B. K. Dutt came of particular use to the industry.

Bata Krishna Dutt was helped in his efforts to raise capital by Himangshu Das, the Shillong agent of the bank, who sold shares worth Rs 95,000 out of the Rs 5 lakh required to qualify for inclusion in the second schedule of the Reserve Bank Act. Several of the agents of the bank and many others had also done their best to sell shares of the bank till the capital reached Rs 20 lakh. Among the helpers, there were Sir Sahdulla, Chief Minister of Assam, who pressurized Mr Hanif of Shillong to give Rs 10,000 by way of share capital, Sir Inder Singh of Chatak Cement and also probably Peary Mukherjee, Managing Director of the company.

During the late 1930s, B. K. Dutt visited Calcutta with the latent ambition of opening a branch there. An experienced agent was elected, folders were printed, but when the idea was placed before Narendra, he disapproved and said that Comilla Banking was going there. However, after Comilla Banking had some branches opened in Calcutta, Narendra gave permission to his son to open a branch in Calcutta. By then, Narendra's bank was established in the city and his son could cash in on his image as before.

When the New Standard Bank Limited opened its branch in Calcutta at 22 Canning Street in the year 1938, larger banks charged two *annas* per cent for collecting cheques on the New Standard Bank. The cheques would be presented at about 11 a.m. Later, a cash van with its back door protected by the *durwans* of the bank, sitting in it like lords, would come to collect cash for the cheques and the collection charges. Efforts were made to drop this charge. The efforts succeeded bank wise, since there was no forum for clearing this issue collectively. The last to withdraw the charge was the then National Bank of India (Grindlays). Jiten Mukherjee of the New Standard Bank brought this news from the National Bank and it was a matter of celebration for B. K. Dutt and his colleagues.

B. K. Dutt used to call on Nalini Ranjan Sarkar, a self-made reputed Bengali businessman and Finance Minister of Bengal. Sarkar was a friend of Narendra and the head of Hindusthan Insurance, a leading Bengali Insurance company, with which the redoubtable Dr B. C. Roy was associated. One day, Mr Sarkar told B. K. Dutt, 'Batu, everyone comes to me for something. You have not asked for anything so far'. Mr Dutt replied that his affection was good enough but 'you can help me by opening an account of Hindusthan Insurance with New Standard Bank and writing a large number of cheques on us.' Mr Sarkar immediately arranged for an account to be opened and, later on, ensured that a large number of cheques were drawn on the bank every month. Dutt was responsible for the sponsored bank honouring the clearing obligations. It was not a dignified status for a sponsored bank. Nevertheless, it worked so long as the sponsoring bank did not abandon its wards. It was apprenticeship, but it saved other banks from the trouble of collecting cash from bank to bank and branch to branch. The second stage was the sub-membership status for the small banks, which required selection by the clearing house member banks. Mr McDonald, secretary and treasurer of Imperial Bank of India (now State Bank) became a friend of Mr B. K. Dutt and assured to help New Standard to become a member of the clearing house. Mr Dutt went to Mr Lalvani of Bank of India to request him to propose or second the application made by New Standard to become a member. Mr Lalvani refused. It was not surprising since other Indian banks did not want to encourage competition and since the large banks looked down upon the smaller ones. However, Mr McDonald ensured that some foreign banks would vote for New Standard. On the voting day, some other member banks voted for New Standard. On counting, New Standard was still short by two votes but Mr McDonald kept the register open and Mr Dutt soon collected the two votes to get New Standard elected. It was a great achievement and the membership status paved the way for further success in the future. B. K. Dutt never forgot those early days when he had to struggle a lot because New Standard was a small bank. In his celebrated diary, he recalls—

> As against such treatment of smaller banks ... a new system soon came into vogue for the smaller banks for clearing their cheques. A sponsoring bank by larger banks in India those days, I recall the treatment meted out to me by the Chase Bank in New York in 1958. It began with a Maharaja dinner. They also invited me to a lavish cocktail party on a boat and arranged for sumptuous entertainment. Overwhelmed by the reception, I told David Rockfeller, President of the Bank, that my bank was a small one. I was told, 'Mr Dutt, I am the President of a Bank and you are the President of a Bank. Size does not matter'. (1994: 40).

After the war, Comilla Banking Corporation made its presence felt even more in Calcutta. It grew fast and raised a capital of about Rs 70 lakh without issue of prospectus, but by a person-by-person canvassing carried out by the staff on a commission basis. Narendra's philosophy of staying near the people paid dividends. Narendra was keen on having a large share capital, but capital could not be raised without the permission of Reserve Bank of India (RBI). The permission was obtained when Narendra persuaded the then Governor of RBI, Sir C. D. Deshmukh, regarding the need for share capital for his bank's growth and safety. By 1940s, the bank had become the biggest Bengali-run commercial bank in the country. With the growing influence of the Comilla Banking Corporation, it became inevitable that father and son had to cooperate more if New Standard was to reap the benefit of this growth. This was pointed out by Sir Deshmukh when B. K. Dutt visited him on some financial matter in 1945. The Governor asked why the son quarrelled with his father. This surprised B. K. Dutt because there was no quarrel at all. He told the Governor that they in fact lived in the same house. In reply, the Governor asked why then should there be two banks in the same house. B. K. Dutt said that probably that was the way his father wanted to train him. The Governor then suggested that they merge their two banks. Those were the days of banking crisis and the small banks with inadequate capital and liquid reserves were very much exposed to the possibility of runs. Thus, mergers of important banks were one way to ensure their financial safety and solvency, and to restore the stability of the financial system. So, it was not surprising that the Governor would be keen to see this merger in eastern India. But B. K. Dutt felt that the time had not come yet as he wanted his bank to reach a certain standard before he went in for a merger. However, the Governor would not buy this argument and said that it was evident from the balance sheet of the bank that it had reached a certain standard and therefore a merger was viable. His final words were, 'You go to your father, get a letter and you also write to me to say that you are agreeable. On return you will find a letter from me supporting the merger' (Dutt 1994: 43). B. K. Dutt went back to his father who said, 'It was you who was not agreeable, I have no objection.' Immediately two letters were sent on behalf of the two banks regarding their desire to merge with each other. Mr Deshmukh kept his word and gave Mr Dutt a very supportive letter. It was the personal initiative of the Governor which ensured that there would be no obstacles from the financial and regulatory authorities.

In those days, bank mergers had yet to become popular in the Indian financial system. The only example B. K. Dutt had before him was the merger of Tata Central Bank with the Central Bank of India. Hence, he went to H. C. Captain, Managing Director of Central Bank of India, for a discussion. Mr Captain was a solicitor in the firm of Shri Phirojshah Mehta who handled the merger and became the Managing Director of the Central Bank of India Limited. Mr Captain said that the procedure that had been advised by the Calcutta lawyers was the only procedure that could be followed. He said that though the procedure was risky, there was no other method one could pursue. On his return to Calcutta, Mr Dutt went to Mr S. M. Bose, who was the Advocate General then. Mr Dutt pointed out an alternative procedure. Sir Bose agreed that it was a legally feasible method but he had doubts as to its operational viability and effectiveness, since nobody in the past had followed such a procedure.

As a consequence, the New Standard Bank had to be put into liquidation and the assets transferred in consideration of the liabilities, without the consent of the creditors, to the Comilla Banking Corporation Limited. To announce the merger to the branches of Imperial Bank of India where the New Standard had branches, arrangements had to be made with the secretary treasurer of the Imperial Bank. The Imperial Bank having spread the message, the information reached all other banks where New Standard had deposits. Mr B. K. Dutt first called Mr S. Gupta, who was a senior Bengali officer. With Mr Gupta's permission, Mr Dutt got an appointment with John Walker, the top officer of the Imperial Bank at Calcutta. Mr Dutt told him that he needed his support in the form of instruction to the Chandput branch (now in Bangladesh) of Imperial Bank, to send telegrams to all the concerned branches of his bank regarding the merger. Mr Walker was initially reluctant to cooperate with a competitor and said so in no uncertain words. At this juncture, Mr B. K. Dutt played his card; he politely pointed out that his bank maintained about Rs 50 lakh in current accounts in Imperial Bank. Mr Walker jumped at this statement and realizing that he was dealing with one of the largest customers, immediately issued the necessary orders. It is an instructive example, which shows that the presence of interbank deposits creates the necessity of cooperation even among the most bitter competitors in banking and Mr Dutt was leveraging this to reduce the otherwise large transactions costs of the merger.

Section 44A of the Banking Companies Act dates from this time. B. K. Dutt started his fight for a special provision in the law for merger of banks. Every time he wrote to the Reserve Bank they would reply back to say that the Central Government would not agree. Exasperated, Mr Dutt eventually sought an interview with Sir Deshmukh. He met the RBI Governor along with Dr Dutt, a Bar-at-Law, and Mr S. N. Sen, a solicitor of eminence. Sir Rama Rao, who was to take charge soon as the new Governor and other officials of the RBI were also present and took part in the discussion. When Mr B. K. Dutt sensed that the discussion was not going in the desired direction, he produced a copy of the Federal Reserve Act of USA wherein there was a special provision for the merger of banks. Mr Dutt showed the relevant section to the Governor 'who read it and went red in the face with anger' (Dutt 1994: 45).

He asked his officers whether they had a copy of it and if so, whether anyone had read it. There was no answer to this question and he threw the book on the table and said to the officers, 'Go and do whatever Mr Dutt says.' Very soon, Section 44A of the Banking Companies Act was inserted in the statute on banking, making it possible for the Governor to sign the order of the merger without reference to the court or winding up of the bank. Interestingly, the United Bank of India was the first bank under the merger provision.

The total paid up capital of New Standard Bank previously was 18.75 lakh with deposits over Rs 1.00 crore and the asset portfolio was quite liquid with most of the assets parked in cash and short term securities. The bank had branches at Canning Street, College Street, Bullygunj, Shyambazar, Mymensingh, Faridpur, Tangail, Asansole, Burdwan, Khulna, Silchar, Sylhet, Shillong, Tinsukia, Jorhat, Chhatak, Ranchi, Jabalpur and Allahabad. The bank had a reasonable presence in Bengal and Assam but the value of the assets of the bank was less than 10 per cent of the value of the assets of the Comilla Banking Corporation. At the time of amalgamation, the total assets and liabilities of the Comilla Banking Corporation were of the order of Rs 15.69 crore. Deposits were of the order of Rs 13.37 crore, while liquid assets were more than Rs 10.00 crore. Among the illiquid assets were advances, bills discounted (these were quasi liquid) and the value of the real estates and buildings of the branch premises. By 1946, it had branches in Calcutta High Court, Burrabazar, South Calcutta, New Market, Hatkhola, Dibrugarh, Chittagong, Jalpaiguri, Bombay, Mandvi, Delhi, Cawnpore, Lucknow, Benares, Patna, Bhagalpur, Cuttack, Hajiganj, Dacca, Nawabpur, Narayanganj, Nitaiganj, Barisal, Jhalakati, Chandpur, Puranbazar, Bramanbaria and Comilla. Nationalist leaders like Subhash Bose, eminent artists, writers, scientists, lawyers, doctors and engineers were among the clients, customers and depositors of the bank.

The bank financed foreign trade significantly from the principal offices of Comilla and Calcutta. It also developed, in course of time, a foreign exchange dealership and foreign bills discounting business with its major overseas partners. The London agent of the bank was none other than West Minister Bank Ltd, while the New York and Australian agents were Banker's Trust Co. of New York and the National Bank of Australasia Ltd.

An Entrepreneurial Vision: Bengal Central Bank Ltd

Jyotish Chandra Das was the founder of the Bengal Central Bank, one of the largest banks in India at that time. The detailed life story of J. C. Das is yet to be recovered. What little is known,[12] so far, is given in an account here. J. C. Das was born at Bidgaon of Bikrampur in Bangladesh in the year 1882. His parents were Umesh Chandra Dasgupta and Bhagabati Devi. His father was an advocate. When his father died, he was very young. Soon after the demise of his father, his mother also passed away. His misfortune started from that time. As a teenager, he was compelled to leave his home on account of his relative's non-cooperation. Then, he started on a new phase of life, full of experiments and adventures, before he could ultimately settle down. First, he joined a shipping company as a kitchen mate. His job took him to distant lands and gave him variety of experiences. In the shipping company job, Mr Rafi Ahmed Kidwai, subsequently a prominent doctor and minister, was his partner. J. C. Das finally left the job, when on landing in Tokyo he heard of opportunities in the big city. He joined a hospital in the city as a lower category trainee staff. After a while, he again found an opportunity to leave his job and this time he left for America from Japan. In USA, he completed B.Sc. and a Registered Accountant (R.A.) course from the University of California. It should be mentioned that an R.A. degree was equivalent to the degree of Chartered Accountant. While doing the accountancy course, his interest in finance was kindled. From his previous experience in shipping, which gave him exposure to the foreign trade business, he developed certain ideas regarding the marriage of entrepreneurship and finance. He realized that the biggest opportunities lay in the mercantile centres of less developed countries. In 1912, he returned to Calcutta and started the Bengal Central Bank in 1916. The Head Office of the bank was initially at Puranbazar at Dhaka. He also started two other institutions, namely, a company called Calcutta Insurance and another called Bengal Central Building Society. The Bengal Central Bank started growing fast and paid dividends to the shareholders at a lucrative rate. It soon became conversant with all types of banking-business like custody, cash management, securities investment, bill discounting, lending on collateralizable securities, and so on. It was the first Bengali bank to be a member of the clearing house system. Between 1920 and 1935, deposit grew at an approximate rate of 200 per cent, and the growth rate of capital and reserves was also comparable (see Table 1.2). Though investment in government and other securities grew at a fast rate, the total volume of such assets was inadequate in the initial years. However, by the late 1940s, the share of investment and other liquid assets had become large (1/5th and 1/2 of total deposits, respectively), enough to bring comfort to the depositors and shareholders of the bank.

Table 1.2 The growth of Bengal Central

	Deposits	*Capital and Reserves*	*Investment in Securities*
1920	Rs 1,41,800.00	Rs 46,399.00	×
1925	Rs 5,01,960.00	Rs 1,51,633.00	Rs 46,073.00
1930	Rs 17,37,689.00	Rs 4,78,700.00	Rs 2,49,947.00
1935	Rs 55,15,779.00	Rs 6,31,321.00	Rs 7,86,117.00

Source: *Byaabsha o Banijyo*; Ashwin 1344: 739.

As on 31 December 1946, the position of the bank was secure and sound. Due to the depositors of the bank was a debt of Rs 1.39 crore whereas other debts to the public amounted to Rs 93,006.00. To meet these obligations or liabilities, the bank's total assets (consisting of cash and bank balances, investment in securities, advances on easily realizable securities and other assets) were worth Rs 11.85 crore. As a result, Managing Director J. C. Das could declare, 'The excess of assets over our liabilities is more than Rs 1.45 crore. That is why it is safe for our depositors'.

The Head Office of the bank was at 86 Clive Street, Calcutta. The bank mainly focused on the eastern region of the country. By 1947, the bank had developed a wide branch network throughout the eastern region. The Calcutta branches were at Harrison Road, Shyambazar, Maniktala, Jorasanko, Burrabazaar, Bowbazar, Bhowanipore, Howrah and Salkia. Other branches in Bengal were in Dacca, Rangpur, Bogra, Berhampore, Bankrura, Krishnanagar, Nabadwip and Jalpaiguri. The bank also had a substantial presence in Bihar with branches in Patna, Ranchi, Upper Bazar, Hazaribag, Kodarma, Giridih and Purulia. Apart from these branches in the eastern region of the country, there were also branches at Bombay, Delhi and Benares.

Bengal Central competed with other banks, which financed export and import business. It had agents in London (the Midland Bank Ltd), New York (the National City Bank of New York) and Australia (the Bank of New South Wales).

Paying Rich Dividends: The Rise of the Comilla Union Bank

On 21 November 1933, Advocate General Sir N. N. Sirkar inaugurated the Clive Street Office of the Comilla Union Bank. While addressing the august crowd gathered on the occasion, the director of the bank, Mr Indubhushan Dutt, recounted the brief but auspicious history of the bank. He said that the bank was founded in Comilla in 1922 with a small capital base and within a few years was able to have an office building of its own. The bank received the patronage of Acharya Prafulla Chandra Roy who inaugurated the new Head Office building of the bank in Comilla. It financed the first jute mill in Comilla and opened the first bank branch in less developed Barishal, which only had loan offices before. After six good years of the bank's operation in Comilla, the directors of the bank felt that a branch should be opened in Calcutta to consolidate the gains made in Comilla. While an office was established in 1928 in a small room on 10 Clive Street Calcutta, it could not be continued due to unavoidable reasons and the bank office moved to the office on 4 Clive Street. Mr Dutt reminded the gathering that it was after five years that the bank had been able to come back to the 10 Clive Street Office. He said that on that date, the paid up share capital of the bank was Rs 1.25 lakh and the reserve funds was Rs 2 lakh; all of which was invested in government securities. Among those who were gathered on this occasion were Mr B. A. C. Civil (Imperial Bank), Mr C. F. Thomas (Llyods Bank) and Mr J. N. Rose (Bank of India). The presence of these gentlemen and that of the press was no coincidence—the bank had fully earned the recognition through enviable commercial performance.

Indeed, the bank had grown from the stature of a small institution in the early 1920s to that of a healthy and buoyant establishment by the mid-1930s. It had seen a tremendous growth in paid up capital, reserves and deposits and the dividend rates had been quite high by any standards (see Table 1.3). It would not be farfetched to say that the investors had vigorously pursued the bank stock given the commercial performance and dividend record.

Table 1.3 The growth of Comilla Union Bank

	Paid up Capital	*Reserves*	*Deposits*	*Dividend*
1923-24	Rs 4,860.00	Rs 850.00	Rs 62,000.00	12%
1926-27	Rs 21,030.00	Rs 24,000.00	Rs 7,46,000.00	20%
1929-30	Rs 83,455.00	Rs 1,39,000.00	Rs 16,70,000.00	20%
1932-33	Rs 1,25,500.00	Rs 2,00,000.00	Rs 21,24,000.00	15%

Source: *Byabsha o Banijyo.*

In 1937, the total deposits of the bank exceeded Rs 1 crore and a substantial sum was accumulated as reserves (which was held in the form of government securities), while the investments, bills discounted and advances grew parallel at a high rate. But the accumulation of real assets was no less commendable—the bank had been able to develop an extensive branch network with 16 offices at Calcutta, Dhaka, Chandpur, Puranbazar, Chattagram, Basirhat, Narayanganj, Nitaiganj, Barishal Maymansingha, Gauhati, Dibrugarh, Tinshukia, Rajshahi, Jorhat and Brahmenberia. The bank was engaged in dollar exchange, having obtained a license from the Reserve Bank. The bank's London banking agent was the Baclays Bank Ltd and the American agent was the Guarantee Trust Co. of New York. In 1940, the management was strong and was in the hands of capable and experienced people. The Managing Director Doctor S. B. Dutt was M.A., Ph.D (Econ, London) and Bar-at-Law.

In fact, the pace of growth and accumulation continued unabated and the position of the bank on March 1949 stood as follows—paid up capital Rs 80.72 lakh, deposits Rs 14,75.00 lakh and working funds Rs 17,30.00 lakh (*Capital* 1949: 439).

Founding of the Hoogly Bank Ltd

Among the *zamindar*s of West Bengal, there were some eminent leaders who engaged in social, political, economic activities and gave leadership to their people. Mr Dhirendra Narayan Mukherjee of Uttarpara District of Hoogly was one such leader. A meritorious student of Presidency College, he engaged in the Independence revolution and very soon took initiative in social, economic and political transformation in his own region. Over the course of time, he became one of the most popular leaders of Hoogly district. He participated in Gandhi's non-cooperation movement after the Jallianwala Bagh incident and led the Hoogly district's salt and tax closure revolution. He spent a considerable time in prison as a result of all this and on release from prison, he came back to active political life by winning the Vidhan Sabha election from Dhaniakhali constituency as the chief whip of the Congress party. He realized the need for the development of institutions if the deeper aspirations of the mother country were to be satisfied and he was equally dedicated to the development of all kinds of institutions, whether schools, libraries, sports clubs, cold storages, and so on. But perhaps his most important contribution of all was the Hoogly Bankers and Traders Co., a company which he founded in 1931 to develop trade and commerce, and savings and investment in the district. Later on, this was transformed into a full-fledged banking company known as the Hoogly Bank. The Head Office of the bank was located on 43 Dharmatala Street. The bank had branches at Chuchura, Royal Exchange Place, Howrah, Bali, Salkia, Belur, Uttarpara, Srirampur and Sheoraphuli. D. N. Mukherjee (MLA) was the Managing Director.

In doing banking business, the bank's approach was conservative with an emphasis on liquidity and safety. In 1944 (July end), the asset-liability position of the bank stood as follows—paid up capital of Rs 5 lakh, reserve fund Rs 1.93 lakh, deposits Rs 1.29 crore, cash balances and bank deposits Rs 31.98 lakh, investment in government securities Rs 35.29 lakh, advances Rs 67.62 lakh, and so on (*Jugantar* 1944). It can be readily seen that the liquidity position of the balance sheet was quite satisfactory and that liquid securities and bills discounted were as important as advances. In fact, this was true for all the four constituent banks of UBI—the advances to deposit ratio did not rise more than 50 per cent for either of the banks, despite the small nature of fixed costs. In fact, the ratio was well below 40 per cent for all the banks for most of the years between 1939 to 1949. Herein lay one paradox of banking—those banks which relied on the liquidity principle seemed to be lending too little money for fixed capital formation and production (as opposed to lending for commerce and trade) and paying a high opportunity cost for safety; while those which ventured to make their asset position tilt towards illiquid and risky production loans were likely to earn supernormal profits in normal and good conditions, but were doomed to failure during recessions and banking panics. It was the prudent principle of building a sufficiently high reserves ratio through consistently having a low advances to deposit ratio in banking; that was at the heart of the safe road to growth and it was the same principle which came to the rescue of the former set of banks during the banking crisis.

Appendix 1.1

Position-wise capital of some of the large banks as in 1934

Name	*District*	*Capital*	*Date of Establishment*
Jagadamba Loan Company	Birbhum	Rs 4,72,000.00	1918
Indian Industrial Bank	Calcutta	Rs 3,72,237.00	1919
Raikat Industrial Bank	Jalpaiguri	Rs 3,04,184.00	1902
Mahalkshmi Bank	Chittagong	Rs 2,42,400.00	1910
Cooperative Hindusthan Bank	Calcutta	Rs 1,68,444.00	1909
Bengal Central Bank	Calcutta	Rs 1,68,305.00	1918
Lakshmi Industrial Bank	Calcutta	Rs 1,66,127.00	1922
Bhabanipore Banking Corporation	Calcutta	Rs 1,25,000.00	1896
Naoga Atrai Bank	Rajshahi	Rs 1,04,059.00	1925
Chittagong Bank	Chittagong	Rs 1,01,550.00	1924
Jashohar Loan Company	Jashohar	Rs 1,00,000.00	1876
Tripura Loan Office	Tripura	Rs 1,00,000.00	1871

Source: United Bank of India Archives.

Appendix 1.2

Ranking of indigenous banks according to deposits as in 1934

Name	*District*	*Deposits (Rs)*	*Date of Establishment*
Jalpaiguri Banking and Trading Corporation	Jalpaiguri	54,60,679.00	1887
Jashohar Loan Company	Jashohar	49,87,313.00	1876

(*Appendix 1.2 contd.*)

(*Contd.*)

Name	*District*	*Deposits (Rs)*	*Date of Establishment*
Bhabanipore Banking Corporation	Calcutta	29,51,082.00	1896
Faridpur Loan Office	Faridpur	28,81,029.00	1871
Rangpur Loan Office	Rangpur	24,50,507.00	1894
Bagura Loan Office	Bagura	21,39,417.00	1874
Bengal Central Bank	Calcutta	16,23,357.00	1918
Cooperative Hindusthan Bank	Calcutta	14,98,103.00	1909
Khulna Loan Company	Khulna	14,67,447.00	1887
Comilla Union Bank	Tripura	13,37,542	1922
North Bengal Bank	Rangpur	11,91,861.00	1903
Faridpur bank	Faridpur	10,14,151.00	1911

Source: United Bank of India Archives.

Appendix 1.3

Rankings of some of the large banks according to loans disbursed (advances) as in 1934

Name	*Advances (Rs)*
Jashohar Loan Company	42,88,683.00
Jalpaiguri Banking and Trading Corporation	41,96,326.00
Cooperative Hindusthan Bank	21,96,326.00
Khulna Loan Company	18,41,994.00
Faridpur Loan Office	16,52,395.00
Bagura Loan Office	16,37,425.00
Rangpur Loan Office	14,88,015.00
Bhabanipore Banking Corporation	12,89,129.00
Bengal Central Bank	12,66,725.00
Comilla Union Bank	12,31,808.00
North Bengal Bank	10,01,738.00

Source: United Bank of India Archives.

NOTES

1. The first section of this chapter draws heavily from Prathama Banerjee (2001).
2. See Kling (1976).
3. This shift did not go unnoticed by contemporaries. The magazine *Mahajan bandhu*, edited by Rajkrishna Pal and published from the sugar *karkhana*s of

Rajendranath Pal and Ramchandra Kundu, clearly positioned itself against the *bhadrolok* attempts at joint-stock business.

4. It is known from the writings of Benoy Sarkar that in the early 20th century there was a tendency to unify irrespective of class differences. Chamber of Commerce of Businessmen, peasant cooperatives, trade unions, organizations of so-called lower class people like Sadgopas, Mahishya, Namasudras, Sahas and even women's organizations were seen. These organizations helped a great deal to build the movement to become free from the exploitations of the moneylenders by building indigenous banks in *Swadeshi* spirit.
5. In a conversation between two eminent entrepreneurs, Narendranath Laha and Jitendranath Sengupta (published in a book called *Desh Bidesher Bank* in 1930), they suggested the establishment of privately owned banks in rural areas. They observed that there was no means of mobilizing the surplus money saved and kept by the rural people, since they were either hoarding wealth or the rural people lent money to neighbours and relatives without taking any interest, or they used the money for usurious money lending or saving in post offices or cooperative societies. Laha and Sengupta suggested that there was a profitable and social role for indigenous banks in mobilizing this surplus in the rural areas.
6. The insurance business was also spreading parallel to indigenous banking. Interestingly, insurance business had a long tradition in Bengal and as early as in 1894–95, there were as many as 86 registered *mofussil* insurance companies being listed in the *Capital* (23 July 1895). Bengalis were trying to float insurance companies as early as in 1865, when, Raja Satya Sharan Ghosh, Ramgopal Ghosh and Pearychand Mitter, among others, formed the Indian Life Assurance Co. The Hindustan Co-operative Insurance Society had Surendranath Tagore, Rabindranath Tagore and Brojendrakrishna Raychaudhuri as founders, and sought to create an accumulation and investment centre that could harness the idle money of the small saver, which was otherwise taken away by the colonial government through the floating of government securities. It is yet more significant in our context that this insurance company was listed by *Thacker's Indian Directory of 1920* as a bank.
7. It was well known that the Marwaris gave preferential treatment to their own kind; the bankers among them would charge lower interest rates from other Marwaris than from Bengalis. Bengali traders borrowing from the *shroffs* would also have to pay much over the bazaar *poorja* rates. Also, the Marwaris represented a more creditable group of customers to the European banks and to the Bank of Bengal—they had a large network of *kothi*s and allied business houses all over Bengal and could complement the branch business of the banks easily. Bengalis did not have a similar network of *kothi*s and those who invested in industry could not count on much support from either the European or Marwari bankers. This was perhaps one reason why soon the Bengali middle classes' emphasis would partly shift from *Swadeshi* industry to *Swadeshi* banks and insurance companies.
8. Of course, the government has a special role in mobilizing capital as well as directing its use in LDCs, but the attendant risk of misallocation of resources through incentive and information problems of planning and conflict of objectives at the political centres has proved this to be at best a necessary and not a sufficient condition for economic development.

9. Another interesting linkage between the formal banking sector and the agrarian world, particularly significant in our context, was through the local lawyers. In Tamil Nadu, the expansion of the legal profession created a significant store of wealth, which went only partly into urban property. The early joint stock banks found a great source of their investment in these cash stores by lawyers. In Bengal too, lawyers ran a profitable business in the so-called *mofussil*s on the basis of numerous rural litigations. In fact, Narendra Chandra Dutta, the founder of Comilla Banking Corporation, which later became a constituent of the UBI, was himself a prosperous lawyer. In general, too, it was well known that lawyers in the *mofussil*s had to be competent in getting bank loans sanctioned to their clients; most banks were managed by local lawyers and the business of litigation drew its profits largely from suits regarding cultivable lands, loan and mortgage recovery, and agrarian property.
10. Banks could also carry on business under the Managing Agency system. Bengal Central Bank Limited with its registered office at Calcutta was also under a Managing Agency till banks were prohibited from having managing agents. Later on, the system was abolished altogether.
11. Note on 'Tea-finance of Jalpaiguri Concerns', by Jogeshchandra Ghosh, Vice Chairman, Indian Tea Planters' Association, rpt. in Ibid., vol.III, p.76.
12. Conversations with the grandson of J. C. Das, Ramkrishna Dasgupta and Professor Bijon Sengupta.

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2

BANKING CRISIS AND THE MERGER

In this chapter, we trace the events that led to the formation of the United Bank of India (UBI) through amalgamation of the four banks of the entrepreneurs mentioned earlier. While it was true that it was the banking crisis of the late 1940s that eventually led to the biggest amalgamation in banking in Bengal, it was equally true that it was the evolution of banking law that led to the merger. In the period between the two World Wars, the scope and definition of banking was sharpened through a series of legal innovations. Following the English example, restrictions were imposed on the activities of a banking firm. During the crisis when the bank merger was proposed by Dutt, there were legal transaction costs that had to be paid in terms of defining what a bank merger really meant in legal terms and how a merger could be legally operationalized. There were also suits filed against the merger bids, thus making the whole transaction even more complicated. There was also a consideration of deposit insurance versus merger as a bank bailout device during a crisis and Dutt spelt out the alternatives very clearly.

1913–1947—The Institutionalization of Banking

A brief history of banking legislation and policies, leading to the post-Independence period, shows the gradual history of the emergence of banking as a separate and special institution. Till as late as 1936, India had no separate laws for banking—evidently, the colonial state, which had its own state-sponsored banks like the Bank of Bengal, expected local banks to function as just another kind of company, under the general Indian Companies Act of 1913. In fact, it appeared as if banking was a less transparent and controlled business—while for non-banking companies, shareholders holding as little as one-tenths of the total share-capital could apply to local governments for inspection of the business, for banking companies, applicants for inspection had to prove that they held as much as one-fifths of the share capital. Clearly, not only was banking not defined as a separate institution, there was no administrative concession to the idea of banking as a public and, therefore, publicly accountable service (Reserve Bank of India 1949: 4). The first banking legislation—the Indian Companies (Amendment) Act, 1936, which added a separate chapter to the earlier Indian Companies Act, 1913—therefore faced the task of *defining* what a bank was in the first place, as distinct from other forms of enterprises. This amendment defined a banking company as a 'company which carries on its principal business—accepting deposits of money on current accounts or otherwise, subject to withdrawal by cheque, draft or order', notwithstanding the fact that it might engage in other kinds of business. The point was to hold a company accountable even if it undertook different kinds of business, if it accepted public deposits at all, that is, if it functioned *also* as a bank. This amendment prohibited banking companies from carrying out businesses other than that specified in the definition. No bank could employ a managing agent other than a banking company. There were also restrictions on the nature of subsidiary companies of a bank. Again, a bank could not be allowed to hold shares in any other company, as pledge, mortgage or absolute ownership, exceeding 40 per cent of the issued share-capital of that company. In other words, the first banking legislation had the primary purpose of defining banks as a distinct institution as well as of separating banking interest from other simultaneous commercial interests, so that owners of a bank could not mobilize public money to fund their other investments, thus, making banking into merely a channel of mobilizing capital for individual businesses, irrespective of the viability of such enterprises and of common public interest.

Yet, even this attempt as a definition was not sufficient to determine whether a company was a bank or not and to hold such a company up to public scrutiny. After the passing of the 1936 amendment, a number of banking and loan companies, mostly in Bengal, claimed that they were not banks at all—and moreover the courts held up many such claims. In November 1939, therefore, a Bank Bill was drafted which tried to further simplify the definition of a bank as an institution. At the same time, faced with the mushrooming of local banks in the inflated money-market of war-time, this bill tried to pre-empt impending bank crashes by suggesting a prescribed minimum capital standard, proportionate to the area of operation and of the population of that area, by suggesting that banks must maintain a percentage of their assets compulsorily in cash and securities and by attempting to ease liquidation procedures so that on failure of a bank, the public got their money back without too much delay. But in context of the speculative money market and political controversies during the war, there could be no unanimity in public opinion about banks and banking. With the result that as an interim measure between 1942 to 1944, it was decided that any company with the words 'bank', 'banker' or 'banking' in its name would be held accountable as a bank, even if the acceptance of deposits on current account, subject to withdrawal, was not its principal business. In 1944, another Indian Companies (Amendment) Act was passed, which sought to further confirm the nature of the bank as a public institution. For one, by this Act, no banking company was allowed to employ a person whose remuneration took the form of a commission or a share of the profits of the company, or a person who had a contract with the company for management for more than five years at a stretch. Second, by this Act, no banking company incorporated after 1937 could carry on business unless its subscribed capital was at least half of the total authorized capital and unless the capital of the company was in the form of ordinary shares, with preference shares allowed only if they had been issued before the passing of the Act.

All this, however, did not quite prevent the crisis of banking companies leading up to the events of 1949–50, which the post-Independence Banking Companies Bill of 1948 had to deal with. Already by the 1940s, there was an undue concentration of banking offices in a few large cities and, at the same time, a mushrooming of small banks involving capitalized expenditure beyond their resources and overly high interest payments in order to attract deposits. It was clear that most of the bank failures of this period were due to the banks making unsecured loans and advances. The new laws therefore prohibited the granting of loans against the security of its shares, or unsecured advances to directors of the bank or firms in which the directors held interest. It was also during September 1949 that there was a devaluation of the rupee leading to much greater speculative activities. After August 1948, there was a serious fall in bank deposits.

The Banking Crisis

But more than anything else, this was the time for bank failures in Bengal, a convulsive experience of which a separate history could very well be written. The context of the Second World War and of the passing of the Bengal Agricultural Debtor's Act together put the banks in a shaky position. The latter involved the scaling down of agricultural debts to below half the loan amount and long instalments without interest, causing many loan companies to go out of existence in the *mofussil* and a general loss in faith in financial institutions (Dutt 1994: 46). The war expansion in the money market caused the opening of many small banks without a sound capital structure—with insufficient reserves, inadequate liquidity of assets and speculative investments. The banks scrambled and competed to attract deposits, resulting in offers of unreal and exorbitant interest rates. Between 1939 and 1945, the liabilities of scheduled banks rose by almost 300 per cent, the major part of which were demand liabilities. The war had tempted many to use public funds for speculative activities. Corrupt and short-sighted managements also often drew excessive salaries and commissions from such public funds. Also, traders and industrialists often wanted sizeable funds under their direct control through banking and insurance establishments, causing a fatal interlocking of interests. Between 1942 and 1945, about 1,500 scheduled bank offices were opened, but very few in areas which were not already being served by running financial institutions. After the war, came the post-Korean boom in commodity prices causing the credit–deposit ratio to shoot up from 49 to 62 per cent. Also, about 900 non-scheduled banks were functioning in Bengal at the time, of which 75 per cent had paid up capital of less than Rs 75,000 and some with less than even Rs 500. At the end of 1946, therefore, there was a run of several banks, including three scheduled banks. Four non-scheduled banks suspended payment and were granted interim moratorium by the Calcutta High Court. The Government of Bengal had to release a press communiqué. Unsigned lists began circulating naming banks which were allegedly mismanaged.

A story in *The Statesman* of 26 November 1946 about the bad financial state of 50 banks caused further panic.[1] The numerous advertisements by banks claiming that they were 'scheduled' banks and 'clearing' banks, and therefore unquestionably sound, added to the loss of faith. In April 1948, the Bank of Commerce was descheduled and resulted in a steady withdrawal of deposits, even time-deposits from many smaller banks. The Calcutta Commercial Bank, the Pioneer Bank, the Mahalaxmi Bank and the Noakhali Union Bank had to suspend payment in September 1948. In early 1949, the run on some branches of the Exchange Bank of India and Africa added to the fear psychosis. The last straw was the failure of the Nath Bank, which, even though bailed out by the Reserve Bank of India (RBI) in 1949, had to finally go into liquidation in 1950.

To the Bengali middle-class perception, the reasons for the history of bank failures were macroeconomic cycles and a combination of inexperience, politics and corruption. A commodity boom or high asset prices usually led to an increase in both the number of loan offices and the volume of average lending by a loan office or a bank. This would expand the volume of economic activity and increase asset prices. Since asset prices increased the value of collateral, this would in turn lead to another round of increase in lending. All this would also increase speculation on asset prices, causing essentially a speculative boom. A shock to commodity prices or asset prices in the international market would end the boom. The boom could also be turned into a bust through a process where high asset prices did not anymore lead to increased lending, since a capacity constraint was reached in lending. Thus, lending would not rise anymore and this would lead to reduction in asset value, and ultimately this would reduce lending, which would further reduce asset prices. Thus, a contractionary process would be started in this way. There were enormous macroeconomic risks that Bengal faced in the first half of the 20th century and a large part of the risks were unhedged due to the underdeveloped character of the financial system. The banking system, instead of smoothing inter-temporal risks through accumulation of reserves and building up the capital base sufficiently, got seduced by the speculative mania of the boom, only to face severe and adverse consequences once the post war bust started. During all this, the government was trying to institutionalize the institution of banking as discussed earlier, but it failed to keep in check speculative lending, corruption and moral hazard of different kinds. Also, the government response to bring about appropriate laws for banking was delayed and lagged after much of the damage was done through excessive risk taking by the banks and loan offices. The main problems were that it was too easy to start banks and loan offices during booms, and that optimal governance of banks were not adequately ensured, either through the law or through investor and depositor monitoring. Brajendranarayan Choudhury was annoyed at the system of nationalist leaders inaugurating banks and businesses, compromising their integrity by associating with risky and profiteering adventures and shaking public confidence. Subhash Chandra Bose, for instance, went to found a bank branch in Sylhet; soon the bank directors had to go to jail (*Smriti o Pratiti*: 182, 189). To Choudhury, it was the sudden increase in the activities of the contractors during the war who could buy the local administration with bribes, which was the real cause for the ill-health of the banks. It was said that making motion pictures was the shortest way to being a millionaire in Calcutta and many bank managers got into this business under false names. Choudhury feared that this history had caused the joint stock and public issue system to lose credibility fully; now only partnerships could survive and would encourage the fatal concentration of wealth in a few hands (ibid.:190–191). Jatindranath Lahiri, manager of the Hindusthan Cooperative Bank, complained that Bengalis depended even now on personal familiarity with creditors, rather than on the balance sheets of the borrower companies, resulting in many loans going bad (*Arthik Unnati* 1926: 264). Much was also made of local competitive politics, which made banks victims of malpropaganda. Thus, in the care of the Central Bank of Comilla, the local village council tried to capture the board of directors, by replacing the preferential shareholders. The depositors panicked and withdrew a lot of money. The local officials participated in this scam and local communal tempers were also fanned for the purpose of this activity. The behaviour of the Bengal National Bank directors who had quietly resigned leaving the posts empty before the bank failed, and released an unsigned and unauthorized statement to the press meant that ordinary middle class depositors had no one to ask for accountability. This further reinforced the general belief that Bengalis were bad in business and good only at politicking (*Arthik Unnati* 1926: 85, 117). In fact, amongst the many reasons for the loss of public faith in banking in the 1940s, B. K. Dutt remembered, was the campaign, unleashed after the descheduling of the Bank of Commerce, by non-Bengali banks against the alleged inefficiency of Bengali companies (*Arthik Unnati* 1994: 47).

J. C. Das argued that the only way of making banks accountable and restoring public confidence would be to start a new technique, by which, instead of accepting deposits against interest, banks should give out preferential shares in small amounts to the general public. The public then would not withdraw money suddenly, causing runs, and would want their money to remain invested for longer periods and greater dividends. In other words, Das argued for the public to own banks rather than a handful of businessmen (Das 1927: 129–130). This early 20th century business mood of corruption and pathos, once again, was articulated by Rabindranath. He begins his short story *Bhaiphonta*, thus— 'As if the monsoon month of *sravan* today has gone bankrupt overnight. Not even a tattered piece of cloud left anywhere.' This is a story where the protagonist invests his dead sister's small savings in his own business and goes bankrupt, leaving her orphaned son to die unattended. Those were the days when anybody thought that he could do business. Interestingly, in this story the reckless protagonist is a Dutt too, as per Rabindranath's sociological tastes! The man tries in substitute everything—familial obligations, love and social respect with money—and that too with the money not his own but of his depositors, including his widowed, sister-like neighbour's (Tagore 1914: 648–660).

By the end of the colonial rule, therefore, the Bengali desire for innumerable, mushrooming business enterprises was all but gone. In 1903, *Kamala* had campaigned for many small enterprises by anybody with the spirit of *Swadeshi*— 'in this world, there is value even of the smallest weed. Previous things are lying scattered all around us; it is only a matter of picking them up' (Basu 1903: 23). The *Arthik Unnati* of 1927 remembers that earlier, decentralization of banking establishments were preferred because there was a tendency of the money from the *mofussil*s to travel in Calcutta, an investment area on which the districts and the countryside had very little control (1927: 790). An author even argued that the successful *mofussil* banks must be given the status of national institutions, which the Calcutta concerns automatically had because they were the real harbingers of economic modernity (*Arthik Unnati* 1927: 81–82). But a few decades into the century, it became clear that the uncontrolled mushrooming small credit institutions, with no banking insurance available, in fact encouraged occasional runs, which could happen at the smallest local propaganda. Also, as the *Insurance and Finance Review* of 1935 noted, such small banks were being unable to withstand competition from bigger non-Bengali institutions. The need was being felt for the amalgamation of banks into larger units (*Tokenholder* 1935: 654). Along with this, need was also being felt for the desegregation of commercial banking from agricultural banking, a combination which to a large extent constituted the foundation of *mofussil* banks (*Tokenholder* 1935: 764–766). From as early as 1915, people like J. C. Das and other local bankers like Jadu *babu* from Jessore, Jogen *babu* from Dinajpur, Girin Gupta from Chota Nagpur and Harinath Adhikari from Rangpur were planning on coming together to form a central bank or loan company in Calcutta, though the plans did not work out. The Bengal National Chamber of Commerce too campaigned around 1935 for an amendment in the Indian Life Assurance Company's Act of 1912 to prevent mushrooming financial institutions.[2] The Chamber also proposed that the *mofussil* banks and their branches would at least have to be reciprocally linked so that quick fund transfers amongst them could help individual units tide over regular runs.[3]

During the period prior to Independence, Bengal had a large number of small banks—much smaller than the constituent units of UBI spread all over the state—serving the common man in regard to his small needs, such as for agriculture, shop keeping, wholesale trade, house building, education of children, marriage, *shradh* or illness in the family. These institutions were, however, looked upon with disfavour because they were paying interest up to 7.5 per cent per annum on *real* fixed deposits and were charging upto 15 per cent on loans. The term for fixed deposits in those days required a few years notice for withdrawal and no loans were ordinarily allowed against term deposits. The branch offices functioned even at such hours as would suit the local people. Since their fortune was tied up with the fortune of the agricultural economy, these institutions had difficulties of existence when agriculture failed, all the more so because they were not in the field of cooperative banking. During the period 1913–24 there was a severe crisis for joint stock banks in India, but the Comilla Banking Corporation, adroitly managed by Narendra, had come out successful during this time of trial. As mentioned before, another set of panic started at the end of 1946 leading to suspension of convertibility by some scheduled banks with the government of Bengal trying in vain to curb the speculative panic.

The weakness of the banks in Bengal became explicit around the time of the country's Independence. There was unprecedented and a large-scale exodus of people across the borders of India and Pakistan, following the partition. The people who migrated to India had to leave everything behind and were obliged to start from scratch and make a living. The unhappy run of events of the time caused an unbearable strain on the socio-economic environment and on the individual banks. By 1948, most of the rural banks, as also the urban-based small banks, closed their doors with a substantially high portion of their deposits outstanding. This, in a situation of overall gloom and despair, set off a chain reaction. A major crisis for the other banks began in May 1948 when the Bank of Commerce was descheduled. In the absence of any measure for deposit insurance and compulsory mergers, it was only natural that runs on the smaller banks would subsequently cause runs on the larger local banks, and that the ordinary people could not make out the difference between illiquidity and fundamentals of a bank.[4] The constituent units of the UBI, it may be mentioned here, repeatedly pleaded for deposit insurance and compulsory merger of banks.

The units faced the crisis with grim determination. During the runs, the Reserve Bank officials went round the branches and addressed the collecting crowds from the top of the counters—'Friends, you are ruining your own banks.' Their exhortations went unheeded. Large crowds assembled for weeks together before the banks' offices to withdraw their deposits. With a huge volume of currency notes on display on the counters, these banks made payments everyday, till the last man left the office premises. Withdrawals of fixed deposits were freely allowed. It must be mentioned that the personnel of these banks discharged their duties during the runs extremely satisfactorily. It must also be noted, that no deserving advance proposal was declined by them even during these days.

Besides, with the onset of the crisis, the management of the constituent units came closer to one another; an informal coordinating committee of the Comilla Banking Corporation, the Comilla Union Bank and the Bengal Central Bank was formed for continually exploring the possibilities of coordinating actions and, if possible, merger of these banks. Merger of other banks was also kept in view.

Unfortunately, the crisis overtook the banks before a merger of strength could take place.

Between 1948 and 1949, India had a continuous adverse balance of trade, which, with the incidence of taxation at prevailing levels, led to high prices and low savings. It was also found that some banking companies were lending liberally against silver in this period, leading to further speculation. Again in April 1950, there was a crisis in jute supply—scheduled banks operating in Calcutta were directed to recall the advances made against raw jute to parties other than mills and balers and refrain from making fresh advances till the price of jute normalized and hoarding stopped. The number of banking offices continued to diminish and many non-scheduled banks ceased to be banking companies in terms of the juridical definition. Yet, there were hardly any applications for the opening of banks in areas where none existed. The suspension of payment by some scheduled and non-scheduled banks in Calcutta led to the final, post-Independence crisis of confidence in banking as an institution.

It has already been mentioned that a banking panic in the form of rumours about the health of banks and steady withdrawals started in 1948. The failure of the Nath Bank marked the culmination of the banking crisis in Bengal.

This was the context in which the merger and the creation of the UBI happened. It must be remembered that at the end of 1949, the nature of the banking sector in Bengal was such that it was particularly vulnerable to financial speculation and, therefore, loan defaults and confidence crises. The greater part of the banks' deposits at this time were demand deposits, especially in the large cities of Bombay and Calcutta. Of these demand deposits, the greater part was held by traders and not manufacturers. Advances too were highest to trade and especially to wholesale trade. The security against such advances was largely non-agricultural merchandise, followed by government securities. This structure of the financial market meant that banks were particularly sensitive to the post-War spurt in speculative activities. And insofar as non-demand deposits went, 97 per cent of the savings deposits and 59 per cent of the time deposits were personal accounts, held by the general public with small savings (Reserve Bank of India 1949: 36–43). Thus, if the composition of demand deposits and bank advances made banks excessively susceptible to commercial speculation, the large share of small savings in the aggregate deposits made banks responsive to change in the general public mood and confidence. Both these characteristics made banking as an institutional system face chronic economic and political uncertainties, at a time when India acquired Independence and adopted the Constitution.

The Merger

It was on a cool morning of 18 December 1950, at the Reserve Bank's office, that Sir B. Rama Rau, the Governor of RBI, who had come to Calcutta a few days back, was anxiously waiting for the clock to strike 10. Also waiting at the Comilla Banking Corporation's Head Office at 4, Clive Ghat Street (now Narendra Chandra Datta Sarani), Calcutta, were the members of the first Board of Directors of UBI—K. C. Neogy, M. P., Chairman, Dr N. N. Law, N. C. Dutt, S. Chaudhuri, R. C. Sur, D. N. Mukherjee, B. N. Chaturvedi, Nawab K. G. M. Faroqi, S. N. Sen, J. M. Dutt, A. K. Chakravarti, K. C. Das and B. K. Dutt. The clock struck 10 and then a ring from Sir Rama Rau to 4, Clive Ghat Street—'I have signed the order of merger.' The amalgamated UBI was formed and the first meeting of the first UBI Board of Directors began.

On the 20 December 1950, the news appeared in *Anandabazaar Patrika* that four principal banks of Bengal had decided to merge in a public ceremony, where West Bengal's Chief Minister Bidhan Ray read an encouraging speech. The state's Finance Minister Naliniranjan Sarkar hailed this merger as the emergence of the earliest first-class bank in Bengal. The RBI governor claimed that this merger was the solution to the great banking crisis of the recent years. Another news item in the *Patrika* on the same day mentioned that the Chief Minister of East Bengal, Nurul Amin, too had expressed pleasure at the event and had hoped that the UBI would work for the betterment of his province in Pakistan. On 11 September 1950, the *Patrika* had already quoted that the State Bank of Pakistan had approved the merger of the four banks into a single UBI. Evidently, the merger of the Comilla Banking Corporation, the Comilla Union Bank, the Hoogly Bank and the Bengal Central Bank at the end of 1950 was an event of some public significance.

Already, before the merger became a reality, public discussions were on about this unprecedented move—the resultant public opinion was mixed. Though few disagreed with the need for such a move, there were occasions when the loss of identity of local banking establishments was seen as lamentable. In fact, N. C. Dutt's speech arguing for the merger, given in the general body meeting of the Comilla Banking Corporation, was reprinted for public circulation in *Anandabazaar* on 6 November 1950. In the speech, Dutt formulated the need for a merger with other banks as a deliberate 'self-effacement' for national good, which was the need of the hour. On 8 November 1950, Sudhindranath Dasgupta published an article in *Anandabazaar*, named 'Bangalir Bank'. For him, the amalgamation was the 'end of an era in the economic life of Bengal'.

> Each of the companies which merged into the single UBI was more than a credit establishment. The names of these individual banks were a daily reminder to Bengalis—how children of resourceless middle class families, through sheer determination and hard work emancipated their countrymen from destitution, how with their help, these boys constructed national economic institutions appropriate to the modern age, how through nation-building they successfully pulled their country and *jati* into the arena of modernity, how they proved that the lack of capital could never keep Bengalis drowned in poverty for ever (Sudhindranath 1950).

To the author, therefore, the loss of the individual names of these banks was a national tragedy, which could never be compensated by greater wealth generation. For the significance of these banks, in the first place, was that these were institutions which could almost be labelled 'banks without money'—banks built with little capital but with enormous collective support from friends and with indubitable nationalist sentiments and self-confidence. In fact, these were very different from the 'war-banks' that mushroomed with speculative intentions and which the Bengalis were right to mistrust—for these were banks which funded the possibility of indigenous tea-plantations, *Swadeshi* textile mills, Bengali-owned coal mines, and so on. The ordinary Bengali public hurt these banks with their lack of trust, at a time when instead of causing runs on these banks, Bengalis should have taken up commerce and industry, and thus strengthened the foundation of the Bengali banking system. In a way, therefore, the author argued, these banks were forced to lose their names and identities because of the failings of the Bengalis to form a *nation*.

Anathbandhu Datta's article published on 6 December 1950, once again in *Anandabazaar*, also reflected on the special place of these four banks in the history of Bengal. Each of these banks, he argued, effectively began as provincial loan offices, with modest claims and resources. The Bengal Central Bank began as the Bengal Central Loan Company, while Hoogly Bank began as the Hoogly Banking and Trading Company. Even though the first attack on these establishments came with the agricultural depression of 1930, these banks had the foresight to very soon open offices in Kolkata and thus establish a link between the *mofussil*s and the city money market. It was this early foresight which allowed the long term survival of these local banking efforts—while in the provinces assets were frozen, Kolkata allowed these banks' access to unlimited liquidity. We have evidence of personal correspondence, for instance, the postcard dated 5 April 1942, between S. B. Datta of the Comilla Union Bank and H. C. Mookherjee, who was also in the Board of the UBI and went on to become the Governor of West Bengal, which discussed the urgency of transferring the bank's headquarters to Calcutta, especially in the light of a possible partitioning of Bengal. During the Second World War, when the money market got artificially inflated and business seemed unlimited, crisis was already being anticipated. Amongst the 15 scheduled banks in Bengal, four went into liquidation, two had to go for reconstruction, the fate of two others were undecided and one was forbidden from accepting any more deposits; 11 non-scheduled banks too failed. The small middle-class depositors lost faith in local banking as a system and flocked to only the large banks. This hurt not only the medium banking establishments, but Bengal's economy and industry in general. And it was this which forced banks with proud individual histories to merge with each other and become a single large banking establishment.

Now, to go on to the story of the merger as an event. The event itself was largely unpremeditated and all the more interesting and unprecedented for it. As we have already mentioned, in 1950, like in earlier years of the mid-1940s, there was a banking crisis in Bengal. The Nath Bank had closed its doors early in the year, after paying most of its deposits through runs, which in turn had caused an additional run on the already depleting resources of the four banks soon to amalgamate. The Hoogly Bank was the smallest of them and suffering most from earlier runs on it. M. G. Mekhri, the then Deputy Governor of the RBI, came to Calcutta in May 1950 and invited S. B. Dutt of Comilla Union, A. K. Roy of Bengal Central, D. N. Mukherjee of Hoogly

Bank and B. K. Dutt of Comilla Banking Corporation to meet at the Great Eastern. He had but one question to ask—was there any way at all out of the perennial runs on Bengal banks? B. K. Dutt replied, off hand, 'amalgamation'. Since the others present kept silent, it appeared that no other ideas were on the table. The point was to let the public know of the decision and thus boost public confidence. The announcement for the merger was scribbled on the back of a torn envelope by K. C. Mitra, the then Deputy Chief Officer of the RBI, Calcutta, and the slip was handed over to N. N. Ghosh of the Reuters by about six in the evening. The news went on air in a couple of hours. The quick public announcement saved the merger, for no one could backtrack on afterthought. The RBI approved the decision to amalgamate *at par*. B. K. Dutt reminisces in his diary, 'As we were leaving Mekhri's suite, D. N. Mukerjee asked me, "What will be the basis of the merger?" "Par", I replied.'

Dutt remembers—

> I am now wonderstruck at the sequence of events. In less than two minutes, without any of us having a chance to consult our respective boards, we had agreed to a merger and unilaterally I had announced that the basis of the merger was to be at par. Had I not said the words 'at par', the question of valuation would have come up at a later stage and fouled up negotiations. Indeed, judging from the prolonged discussions that later took place, but for my initial instant reply in the two words, 'at par', the amalgamation might not have taken place at all and the severe runs on banks would have finished us all. I call it fate (Dutt 1994).
>
> But it was not all smooth sailing, though the Reserve Bank helped a lot in formulating amalgamation procedures and with documentation. Shareholders' meeting were called. Yet, when everything seemed ready and was going according to plan, one Mr D. N. Guha, a retired judge and the author of a few law books, filed a suit to stop the merger. His contention was that he had been defamed and was entitled to damages because the Comilla Banking Corporation had made a wrong demand of Rs 33 or so by an open letter. If Comilla Banking went out of existence, he said, his claim would fail. Guha obviously meant business and engaged a very senior counsel, probably R. C. Deb, to defend his case. We had Sachin Choudhury, the celebrated barrister, who later became the finance minister at the centre, on our side. Choudhury was worried that such a situation should develop right on the eve of the proposed merger. The matter went before Justice Bachawat on the Friday preceding 18 December to be heard in camera. The

> counsel for the petitioner insisted that he was entitled to an injunction under the law. The judge refused to grant it. On being advised that he could not refuse an injunction, Justice Bachawat replied, 'But I have just done so!' The petitioner then wanted leave to appeal. The Justice fixed the date and time for hearing the leave petition on Monday, 18 December 1950, at 11 a.m. The plaintiff said the merger was going to take place at 10 a.m. that day. The judge said, 'That is why 11 a.m.' Everybody was amazed at the stand taken by Justice Bachawat, obviously in the greater interest of the grave issues of economy that were involved in the merger. To this and me that was the only hurdle we had to face before the merger was completed was overcome by the grace of God (ibid.).

The UBI gratefully remembers the contribution of such personalities like C. D. Deshmukh, B. Rama Rau, K. C. Mitra and the Reserve Bank officials who rendered extensive support during the negotiations leading to the merger and maintained a keen interest in the amalgamated bank. In particular, it was because of Deshmukh that in the Banking Regulation Act, 1949, the provision for amalgamation was made. Among those who rendered valuable services in the early days were H. N. W. Laughland (formerly of the Imperial bank of India), who, at the instance of the Reserve Bank, joined UBI as its advisor; B. N. Chaturvedi and S. Chaudhuri, the former finance minister of India. Their contribution was very large in developing real unity amongst the top management personnel of the erstwhile competing banks.

Just before the merger, while agitation by the bank employees and constant runs on the banks were on, an important incident took place which was to have far reaching effects on banking. This was the formation of the first national level banking tribunal—Sen Tribunal appointed on 13 June 1949.

It is interesting to note that Mr B. K. Dutt was appearing before Justice Sen only on behalf of Comilla Banking Corporation, despite the fact that the merger was imminent. In Mr Dutt's words— 'Other amalgamating banks did not take any interest'. Mr Dutt tried to impress upon Justice Sen, the chairman of the new tribunal, the following views held by him:

(*a*) Banks should be classified on the basis of working funds per capita of staff and not on the basis of aggregate size of deposits.
(*b*) Total staff cost should be subjected to a ceiling ratio to working funds or deposits.

(*c*) Where a bank suffered a severe setback, it must get special consideration.

However, the large banks in Bombay opposed the move. H. C. Captain, Chairman of Central Bank of India Limited, was their main spokesman. Central Bank had a deposit of about Rs 1,20,000 per capita of officers, clerks and sub-staff taken together. The Bank of India had Rs 4,00,000 and United Bank had a per capita deposit of about Rs 72,000. It was Mr Captain's suggestion that the Central Bank of India should be classed together with the Bank of India and the UBI. Thus, all earnings were swallowed by staff salaries and UBI was the worst sufferer as its resources per capita were too low and ratio of cost of operations rose too high.

Thus, from 18 December 1950, the UBI began functioning in the amalgamated form. The constituent units were placed as listed further. It will be seen that by 1949, the deposits of all the constituent banks had fallen substantially, testifying to the general banking crisis of the times and to the indisputable need for the act of the merger itself. The figures are taken from a mimeographed paper produced by the UBI, Research and Development Department, undated but probably produced around 1971 as a reconnaissance of the 'UBI Story' (see Table 2.1).

Table 2.1 Reconnaissance of the UBI Story

Name	*Founder*	*Place of Origin*	*Date of Incorporation*	*Deposits: 1947 (in lakh)*	*Deposits: 1949 (in lakh)*
Comilla Banking Corporation Ltd	N. C. Datta	Comilla	8 October 1914	1,555	1,145
Bengal Central Bank Ltd	J. C. Das	Calcutta	16 March 1918	1,015	776
Comilla Union Bank Ltd	I. B. Dutt	Comilla	5 September 1922	1,483	953
Hoogly Bank Ltd	D. N. Mukherjee	Calcutta	16 August 1932	446	292

Before the actual amalgamation in December and the decision taken in May, the idea of merger was passed through the general bodies of each of the banks. Speaking at the extraordinary general meeting of the shareholders of the Comilla Banking Corporation Ltd in Calcutta, on 5 November 1950, convened for the purpose of the amalgamation, the Chairman N. C. Dutt said that the merger was considered with a view to eliminate avoidable expansion in mutual spheres and realizing the unity in circumstances governing ownership and operation (*Capital* 1950: 726). However, he made the role of the Reserve Bank in the merger clear to the shareholders and indicated that the merger was viewed as a necessary step from the viewpoint of the banking system as a whole. The task of the merger was to construct a 'storm free institution' that would restore the faith of the common people in banking institutions and stem the panic in Bengal. The Minutes of Comilla Union Bank enumerate the following important decisions which were taken one after another:

(*a*) Progress regarding the discussion for amalgamation of the three banks reported a careful wait and watch policy regarding Bengal Central Bank Limited.

(*b*) The question of amalgamation of the three banks, viz. Bengal Central, Comilla Union and Comilla Banking Corporation. A draft letter and resolution were to be addressed to the RBI by each of these banks.

(*c*) Board is agreeable with respect to the amalgamation with a view to inaugurate a big Bengali managed institution in the province and confirm the decision of the working committee in this connection.

(*d*) Suggested that there should be joint directorship and the joint managing directors should be Dr S. B. Dutt and B. K. Dutt and the alternative managing directors of the three banks should work as a working committee for the management of the amalgamated bank and the merger should not be under present law, but only when the law was simplified, as suggested by the three banks.

(*e*) After the Hoogly Bank joins the merger scheme, the managing director presents the proposed scheme of amalgamation of the four banks and the constitution of the new board of directors. It is approved by the then present board and resolution submitted to RBI.

(*f*) Dr S. B. Dutt, A. K. Chakravarti, Nawab K. G. M. Faroqi nominated as directors of the amalgamated bank.

(*g*) The memorandum of association of Comilla Union Bank Limited altered by adding the following clause— 'Amalgamating with any other Banking Company or companies in such a manner and on such terms and as for such consideration as the company may think fit' (1941).

(*h*) An extraordinary general meeting of the shareholders required before the merger could take place—managing director acting on advice of the legal advisor, since there was no specific provision for amalgamation.

(*i*) The managing director places before the meeting, the copy of the notices to appear in the Pakistani press and also the Indian press in connection with the merger.

(*j*) Resolved that the bank, in view of the amalgamation, recommend the appointment of an experienced banker approved by the RBI, for a period of three years, as an advisor to the board of directors. He will attend the daily meetings of the committee and have direct access to the chairman of the board. He will also have access to any papers required by him. Among his duties will be the reorganization of the amalgamated banks and closure of branches that were working at a loss, or have become superfluous as a result of the amalgamation. He will also prepare manuals of instructions for branches and for different sections of the Head Office, with a view to establishment of sound banking methods and practices.

Since this was a time when there were no legal provisions for mergers of banks, for technical reasons, the Bengal Central Bank of Calcutta was appointed the transferee and the other three banks transferred their assets to the former. As a result, the UBI Ltd was set up with a paid-up capital of Rs 2,64,61,952. The combined reserve fund was Rs 1,18,07,764.

In December 1947 for which, published balance sheets were in the hands of the public—the approximate position of the amalgamating banks was as shown in Table 2.2.

Table 2.2 The approximate position of the amalgamating banks

Owned funds (capital and reserves)	10 per cent of the deposits
Liquidity (comprising cash, government securities and money at call)	80 per cent of the deposits
Profits per annum	1 per cent of the working funds

Just prior to the beginning of the runs on these banks in 1948, the deposits of the amalgamating banks were of the order of about Rs 45 crore. On the date of amalgamation, deposits had come down to about 23 crore, capital and reserves to about 3.7 crore and liquidity accounted for about 65 per cent of the deposits. During 1948–50, the deposits declined by a little less than 50 per cent despite the fairly high liquidity of the banks, adequate owned funds, a mere 1 per cent salary ratio, 1 per cent interest rate on deposits and profits of just 1 per cent. These declining figures must be read while simultaneously imagining the crisis context—the large crowds daily in the bank offices, huge volumes of currency notes on display on the counters, payments being everyday till the last man standing in the premises left and the banks allowing a free withdrawal of fixed deposits. The RBI officials were seen making rounds of the banks, often shouting at the customers that they must refrain from running their own banks.

In 1951, in spite of a sharp decline in net earning as deposit, resources had declined by 50 per cent and a high liquidity was being maintained for fear of runs; there was a sharp rise in salary bills from 45 to 65 lakh rupees (it must be mentioned that the amalgamation did not cause any retrenchment of the workforce). For the year 1950, the dividend was 3 per cent against the 7.5 per cent normally given. As a result, another period of decline in deposits set in. Also, some speculator-buyers, though small holders, maintained a campaign that the UBI was being managed inefficiently because the dividend was not going as high as that of other banks. The stock-exchange quotation for a 10 rupee fully paid-up share hitherto sold up to 17 rupees, now declined to around three rupees. The old rate of dividend of 7.5 per cent could only be restored as late as in 1963. At the same time, a struggle with the workers developed. Also, as a result of the decline, the riots and the partition and because the banks had to maintain an increased liquidity at any cost by forced liquidation of advances; a good portion of the advances became *hard*; interest on which could not be charted for credit to the profit and loss account. The amalgamation also required the merging of overlapping branches; consequently the number of branches fell from 148 to 94. Around 1950, there were 15 branches of the UBI in East Pakistan, which continued to function as before till in 1965, when these were taken over by the Pakistan government (UBI 1971).

The process of the merger, especially because there were no precedents for such acts, was fraught with disagreements and difficulties. One, there were numerous overlapping branches of the four banks, some of which had to be merged, some shut down. This gave rise to an excessive workforce, which had to be accommodated. The workforce also had divided loyalties, having worked in separate establishments as did the superior officials of the banks. Second, with the merger of the four banks, there turned out to be too many classes of shares of the UBI, causing massive problems in stock-exchange quoting. (It may be mentioned here that soon after merger, a call of Rs 2-8-0 per share was made with respect to partly paid-up B-class shares of the Comilla Union Bank, which brought in an additional capital of Rs 5,00,000 to the UBI Ltd). Third, the centralization of the Head Office brought additional difficulties and issues of divided authority, as well as the question of reconciling different account systems maintained by the different banks.

But the real difficulties and disagreements arose in terms of the uses and functions of the bank's capital and reserve funds and of the systems of accounting these. In a way, these difficulties were brought over from earlier times, when banking was a well-entrenched practice, yet banking was to emerge as a homogeneous legal and institutional system. Mergers were therefore difficult, and largely experimental acts. If there were no hiccups when B. K. Dutt's New Standard Bank Ltd merged with N. C. Dutt's Comilla Banking Corporation, it was largely because the owners came from the same family. A similar attempt at merger between the Brahmanberia Laxmi Bank and the Comilla Union Bank in 1940–41 was however not so easy. J. C. Sen, the agent in Calcutta, pointed out that the way in which the outstanding interests due to the Laxmi Bank were transferred to Comilla Union was faulty. The latter bank placed this interest amount in the Special Reserve account, even though the interest had not yet been realized and did not form part of the profits. Yet, the bank advertised the reserve fund as including an amount which should have remained in a suspense account. The accountant also argued that since the special reserve formed part of the depositors' money, it could not be advertised, as it was done, for investments in securities. Also, the bank was criticized for writing off bad debts and security depreciation from the reserve rather than from the profit and loss account. The Comilla Union was therefore showing an artificially inflated profit. The Managing Director of Comilla Union Bank, Shantibhushan Dutt, however, claimed otherwise—that accounts could be calculated on the basis of accrued income and that it was incorrect to say that the surplus due to amalgamation could not be taken into the reserve. For surplus out of mergers was a special one-time surplus and, therefore, should be used to compensate special losses like bad debts and remissions. In any case, bad debts and depreciation—he argued—were not expenditure but 'unforeseen' losses and the reserve was meant precisely for such losses; to think that the reserve is a fund which should not be touched at all was an error. These definitional differences caused so much bad blood that J. C. Sen was accused of spreading rumours in Calcutta against the bank and was soon sacked (*Minutes of the Resolutions of the Board of Directors* 1941).

When the UBI was created out of an amalgamation, similar problems appeared. It seemed that an assessment of the collective assets of the four banks showed an enormous amount of bad loans and advances, which could not be accounted for in terms of the usual profit and loss calculations. A major 'surgical operation', as the Chairman K. C. Neogi termed it, had to be performed upon the total reserve of Rs 1,18,07,764-9-2 and a large sum of Rs 23,00,000 was appropriated and transferred from the reserve fund to the head of 'current deposits and contingency (unadjusted) account'. This was because 'certain of the pre-amalgamation units obviously regarded the General Reserves as taking care of Doubtful Debts not classified as bad' (Chairman's speech 1951). Also, Rs 21,00,000 had to be appropriated from the reserves and added to Rs 1,00,000 from the current year's profits, thus creating a special investment reserve. This was necessitated because of the serious recession in government security values and because certain pre-amalgamation units in their investment portfolios had a large proportion of long-dated securities, liable to much greater deterioration in value. Of course, in addition to all this, another portion of the reserve—in fact, as much as Rs 15,00,000—had to be set aside to meet the possible contingencies in East Pakistan, into which Comilla had passed after the partition. On the other hand, one of the pre-amalgamation units used to set aside a fair sum as a 'dividend equalization' fund, which had to be merged with the general reserves after appropriate debate and discussion. It is evident, therefore, that an unprecedented act like the merger had to primarily face the problems which arose, not only because of the lack of appropriate laws, but also because the system of accounting in banking and the structure of banking capital was not yet fully defined and institutionalized.

Merger Versus Deposit Insurance as a Way to Avoid Banking Panic

Even though at the time the event of the amalgamation came into news as the singular solution to the 1948–50 banking crisis, B. K. Dutt—the person who proposed the merger in the first place—himself knew of the limits of amalgamation as a procedure in context of an underdeveloped, ex-colonial nation. In a speech on 'Amalgamation as a Method of Bank Consolidation' (undated), Dutt agreed that at a time when quick bank expansion was the need of the economy, amalgamation seemed the surest and the shortest way to it. Yet, he also remembered that in the banking crisis of 1948–49, superiority in size and in the structure of a bank's capital did not necessarily prevent or stop persistent runs. In fact, Dutt emphasized that many of the banks which failed during this time were not unviable in size and structure—some could maintain a liquidity ratio of over 55 per cent, some had only 35 per cent of their capital locked in advances and some could, in fact, pay out 70 per cent of their liabilities before they closed. One can only come to the tentative conclusion that it was the magnitude of the crisis that led to the liquidation of the banks which were relatively larger, sufficiently liquid and with a reasonable capital structure. To Dutt, mergers could restore confidence in banking institutions to a certain extent, but other measures were also needed since mergers were necessary but sufficient conditions to save banks from collapsing. Modern economic theory tells us that crisis would not have beset these banks, had deposit insurance been there to counter the negative effects of ill-founded rumours. In the absence of deposit insurance, bank runs became self-fulfilling prophecies (Diamond and Dybvig 1983: 401–419) since, when all depositors simultaneously run on a bank, then under a fractional reserve system of banking, the bank is bound to go insolvent. Further, the history of banking panics throughout the world testifies to the fact that when bad banks suspend payments, they exert a negative externality on the otherwise viable ones by spreading false rumours, thus causing their insolvency. Therefore, deposit insurance was necessary to safeguard against these dangers. Conservatives might argue that deposit insurance can lead to complacency and excessive risk taking by banks, unless the insurance premium can be suitably adjusted to risk (a difficult job for the insuring agency), as the recent financial crises reveal. It is difficult to infer whether Dutt realized that there was this 'moral hazard' problem with the insurance concept.[5] He argued that amalgamation might lead to a great rise in operational costs, without engendering the expected economies of scale. Also, amalgamation led to psychological insecurity and internal resistance, a resolution of which was a tedious and time-taking process which the country could not quite afford. But above everything, amalgamation eliminated local competition and created monopolies, which harmed the public because banking was a service which should thrive in the context of competition. According to Dutt, amalgamation as a method gained legitimacy in India because of its success in the United Kingdom (UK). Very few realized how different the institutional contexts were in the two nations. In UK, most mergers happened because banking houses were sold in the market to corporate buyers, the banks being mostly family or partnership businesses which anyway could not have operated in perpetuity like joint-stock banks with limited liability, as was the case in India. In the United States, however, when more than 6,000 banks crashed in 1931, it was not followed by amalgamation, but by other methods like insurance. In Germany, banking consolidation had been carried out not through mergers, but through an actual division of larger banks into a number of smaller ones, which were supposed to assist regional development. In India, therefore, unlike in England, Dutt believed that amalgamation itself could not make a better bank, unless an adequate supply and distribution of fresh capital was available. But he also knew that sufficient capital could not come easily from the market in the current context, so in 1957, he suggested the appointment of a standing Banking Expansion commission. Dutt's appeal to the policy makers to insure bank deposits thus had impeccable logic and a keen historical insight which would make many modern finance theorists and economic historians proud. However, those belonging to the school of thought started by Bagehot would not agree (1873). According to them, saving imprudent bankers would be a mistake which would make history repeat itself. Modern iconoclasts in the world of theoretical finance like Douglas Gale and Franklin Allen would see optimality in bank runs (1998: 1245–1284) and tell the policy makers to allow runs because things 'would get worse otherwise' (a concept foreign to even a free marketer like Milton Friedman [1963: 860]). Fortunately for the common banker, there exist some counter arguments on these issues. Since differentiating between the prudent and not so prudent ones would not be a favourite job for the hard pressed monetary authorities, their real dilemma would be whether to save all, at the cost of keeping a few irresponsible ones alive, or allow some of the risk averse but unfortunate ones to die, in order to keep banking society free of risk lovers. Dutt, for one, pointed out, that closure of banks en masse would not only cause a gaping lack of credit services in all the regions, but also cause widespread unemployment, disrupt local economic activities, including trade in agricultural produce and ultimately have a large effect on all the sectors of the Indian economy. On the welfare aspect of crisis, one can argue that liquidation of banks would be costly to society when the problem is not with 'fundamentals'[6] but with 'state of the mind of the depositors'. One would be inclined to think that this was the reason why Dutt also argued for a Rehabilitation Finance Corporation as an institution complementing the Deposit Insurance Scheme. Another reason was that regulation had to have preventive as well as curative aspects, as far as banking crises were concerned.

In 1956, Dutt was already trying to campaign for a well thought-out procedure for rehabilitation of banks. It seemed that in those days, it was commonsensical to complain that sub-standard banks were operating in the remote localities of Bengal and to suggest that such local and small banks should be closed down. Dutt, however, insisted that closing down these banks would not only cause a gaping lack of credit services in the region, but also cause widespread unemployment, disrupt local economic activities, including trade in agricultural produce, and even affect the rural cooperatives and the postal banking services. He argued that a Rehabilitation Finance Corporation, owned either by the RBI or the government or both, should work towards arranging mergers as well as towards the conversion of these small, local banks into subsidiaries of other banks, whose deposits had been impaired. The Corporation could even arrange with licensed banks for taking over their management on behalf of the Corporation and taking over some or all of the assets of these banks. The Corporation could then organize the progressive disposal of the banks' shares, held by the Corporation—in the first instance to the licensed banks and then gradually the shares could be resold to the public, once the banks made into subsidiaries could again begin to function independently. Such a process would also have an additional advantage because instead of removing banking opportunities from the localities, the retirement of redeemable shares through replacement, by public issue or out of accumulating profits, would call for and therefore generate increasing banking activities in the regions. More than mergers, it was this state-overseen creation of an economic atmosphere in which banking practices would have to be more popular, combined with deposit insurance, which would make banks into stronger and more proactive institutions (Dutt 1956). In fact, later Dutt even went so far as to say that the Indians had made a fetish out of the idea of 'economies of scale', which did not do much more than make the banking system more impersonal and alien to the public and less amicable in terms of worker–management relations[7]. But above all, the size-oriented thinking had caused a lack of banking services in non-metropolitan centres of the nation.

> That only 22 separate banks are in the national sector, is not a historical accident as such. If appropriate actions had been taken when the number of banks had been 500 and the estimated sub-standard assets were not more than Rs 25.00 crore, the country would have had 500 or so banks today, rendering the services we want to render currently.[8]

B. K. Dutt's analysis of the limits of merger as a procedure of bank consolidation and of the utility of large centralized banks was based on his characterization of the decentralized nature of the Indian economy itself. In the late 1950s, banking activities were indeed expanding in scope. For instance, the acceptance of the idea of making medium-term loans to industries by commercial banks was a big step forward, for in the colonial times such loans were generally inadmissible for commercial banking establishments. But Dutt realized that expansion only in terms of the banks' functions was bound to remain inadequate until the institutional structure of banks was readjusted, to allow the integration of the non-monetized sector to the organized sector. Otherwise, attempts at creating bank liquidity and increasing the velocity of money through increasing bank advances were resulting in a shift of resources from the unorganized to the organized sector, from villages to cities, making the former even less prosperous and unjust. On the other hand, conventional attempts to control the organized sector were resulting in a growth in the absolute turnover in the unorganized sector, which escaped credit control and other traditional remedies undertaken by the central bank.[9] Yet, merely the opening of new branches of centralized banks in rural areas was ineffective, for such branches could neither be sufficient nor be profitable. So, Dutt argued for the opening of 'unit banks' all over the country, even though some argued that in face of the currently popular idea of reduction in the number of banks through amalgamation, such unit banks were 'primitive' institutions. Dutt argued that in place of the vertical expansion of banking institutions, operating on centralized norms and terms, a horizontal expansion could make banking as an institution sensitive to local and specific industrial and employment needs.[10] In fact, at the insistence of the Bengal National Chamber of Commerce, Dutt wrote a detailed scheme for the system of such unit banks, which was submitted to the Rural Banking Enquiry Committee appointed by the Government of India in November 1949, under the chairmanship of Purushotamdas Thakurdas. The Committee submitted their report in May 1950, which was released in a printed form in 1953. It was a novel document which carefully analyzed the agency problems that can arise in branch banking and how rural unit banks would be a superior alternative. He also painstakingly showed how such unit banks could mobilize resources for investment at a faster rate, without having to take excessive risks and how a little community participation could make them viable organizations. However, his plan was silent on allowing competition between banks with branching permits and which raises the quality of banking service. Surely, he could learn a Smithian lesson or two on this issue, but having said that, one must not forget that many banks have retained their regional nature despite free interstate banking in today's democracies (Gale 1993).

It is thus clear that even though the UBI was created as a large, urban bank through amalgamation of small provincial establishments, the early 20th century Bengali dream of small banking institutions serving the countryside was still alive—despite the dream having faltered before a long and seemingly irresoluble history of crashes and runs. This was a 'dream of hundreds of small banks with beautiful small buildings with adjoining godowns and innumerable other amenities ranging from radios to medicine stalls', as Dutt (1994) described it as a system of islands of modernity, thriving amidst and leading the people of rural India to a better economic and social future. Dutt was clear that if a few banks in India were to hold the entire resources of the country for the benefit of principally urban debtors, nationalization of banks might be accelerated and that this would have to be explained to the commercial banks who opposed the rural banking scheme. The commercial banks would have to realize that they would obtain a share of the newly found resources, deriving from the chain of clients served by the rural area banks without the inherent risks of ordinary branch expansion. They would also have to realize, Dutt argued, that it was the big and urban nature of commercial banks which have resulted in the 'evil' and 'anti-social' image of banks in public perception. In fact, it was precisely such banking establishments that were too big to permit a sense of ownership and sharing amongst the workers, which had given rise to the trade union movement in banks in Bengal and which had 'removed the spirit of service in bank personnel'.

Notes

1. Letter from Bengal National Chamber of Commerce to Government of Bengal.
2. Letter from the Chamber to the Secretary Bengal Legislative Council, 1935.
3. Letter from the Chamber to Government of Bengal, Finance, 1946.
4. Fundamentals of a bank are said to be sound if in the absence of a bank run, all deposit claims can be paid.
5. See also J. Stiglitz and A. Weiss (1981).
6. Conditions under which as long as depositors do not all simultaneously run on the banks, every financial claim can be paid, is known as a situation of sound fundamentals in banking industry.

7. Debate on economies of scale in banking continues even today.
8. Dutt, speech given in the Top Management Conference, NIBM, 1973.
9. Dutt, speech at the Jorasanko Branch of the UBI, 1957.
10. Dutt, speech, undated, probably between 1949–51.

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POST-MERGER DEVELOPMENTS (1950–1969)

The post-merger years saw the focus of the bank shifting to that of growth and development from that of maintaining stability. This was true for the United Bank of India (UBI) as well as for the banking system in general. The hopes created by the socio-economic visions of the time was the fundamental reason behind this paradigm shift. This period also witnessed a series of bank mergers in all the states. At the local level, to a certain extent, this process was detrimental to competition. At the country level, however, there was more competition because the mergers produced banks with enough resources to branch across state lines and shed their narrow regional character. However, the extent of actual interstate branching and geographic diversification was rather limited. During this period, UBI gradually got a foothold in some of the major metropolitan cities of India, but its growth was primarily fuelled by the industrial and trading requirements of Bengal and the north-eastern states, and the growing savings of the Bengali middle class. In this chapter, we shall revisit some of the salient features of the Indian economy and policy, and consider its ramifications for the banking industry. This would help set a benchmark model of growth of a typical Indian bank of this period and our discussion of UBI will then proceed in the context of this benchmark. Before we delve into some of the statistical details of the bank's growth, we must, however, take a short detour into the vision of the model banking system that B. K. Dutt thought was the order of the day. This established, more firmly, the reputation of the bank management as one of the thought leaders in banking policy of that time. This had a positive effect as far as the bank aspired to be a country level bank, an ambition which required public image of the top management and access to important corridors of finance and power. To an extent, the management of the bank was also influenced by the philosophy embedded in the vision of prudential banking model. The 1950s and 1960s saw robust growth, but with an increasing exposure to risks. We have tried to analyze the efficiency of the bank management using some important financial ratios. Comparing with some other banks on these parameters reveals that from the early days, the bank was burdened with some difficult problems. The initial conditions of the organization had a telling effect on the profitability, throughout the period. As we shall see in subsequent chapters, the bank became increasingly vulnerable to these conditions when the burden of nationalization and regional economic problems were simultaneously imposed. However, this is not to deny the prudence exhibited by the bank management (though subject to the dangerous combination of capital constraints and high growth aspirations which characterize financial institutions in the early stages of development [Cameron 1967]), in harnessing core skills and developing new ones. We end the chapter with a discussion about the prudential banking in which UBI engaged through these years and the role of the financial press in facilitating the institution of banking at the industry, as well as the individual bank level.

The Economy and the Financial Structure: Some Implications for Banking

A natural place to begin would be the population burden at the time of Independence. It kept the per capita income at a very low level to begin with and, together with wealth inequality, it had generated poverty for 70 per cent of the population. It therefore necessitated the spreading of social wealth too thinly over the population, if poverty reduction policy was to be at all effective. Further, with a slow per capita income, it was hardly possible to generate enough savings from a majority of the population, especially the agricultural poor. The low levels of per capita income also caused tremendous strain on the health care and human capital front. Undernourished, undereducated, vulnerable to exploitation and with low access to technology and assets (except, to some extent land), the population of the country had no wherewithal for growth and improved standard of living and looked at the government for filling up the gap between actual and aspired well-being. The critical minimum push required from the private sector through effective demand, savings and technological progress, in order to generate a significant positive externality, was missing. Here again, the efforts had to come from the government, and a minority of savers and borrowers.

Economic life that generated some surplus and showed some traits of early economic development was located in a few metropolitan centres. These became the heart of the banking community and trade. This was, in effect, a British legacy. Hence, British style commerce and banking, and industry coexisted side by side with the poor agrarian economies of the countryside and the old mercantile classes of the city. The mix of the *deshi* and *bideshi* styles created a duality in the financial markets labelled as unorganized markets, dominated by indigenous bankers, and the organized sectors, dominated by scheduled commercial banks, with the mercantile foreign banks playing a stellar role. However, banking had ceased to be an instrument for siphoning off the surplus of balance of payments and to promote commerce for the sake of the British managing agency firms (Bagchi 1997). The new requirements of banking were felt by the enlightened Indian milieu, and the economic planners and social visionaries, and the stage was set for the Indian banks to grow both in scale and scope, and complement the economic aspirations and tools of the five-year plans.

The five-year plans, in principle at least, created a transparent medium through which the panoply of socio-economic visions could be more precisely articulated, concrete targets set and the input requirements understood. The emphasis on heavy industries and accumulation (future consumption rather than present) entailed a generational sacrifice, which seemed worthwhile *ex ante* (in an overlapping generations framework of today's economic paradigm or the traditional two sector model which was fashionable then).

The second five-year plan emphasized investment, modernization and accumulation but its pitfalls lay in not emphasizing value addition, quality and cost effectiveness. Therefore, the returns were not commensurate with the investments made and eventually the burden was felt by the banking industry. Another legacy of the early planning was the cost plus contracts, which diverted the attention of industry from focusing on cost reduction and efficiency. Later on, as industrial sickness spread and governments cut back investment or made sectoral reallocation, the resultant inefficiency and excess capacity created structural adjustment problems. The financial sector's pattern of accumulation of sick assets can be traced back to these problems of planning.

The second five-year plan gave rise to a strong demand by the government machinery for heavy engineering, machineries and raw materials. Further, it gave rise to expectations of profitable growth to many indigenous traders and manufacturers through the backward and forward linkages of these industries. These ancillary industries around the core industries and towns became major clients of the commercial banking system and helped them accumulate their assets and utilize the deposits. The backlogs and delays in plan implementation also caused a lot of financial problems for the contractors, ultimately taking the shape of not only excess capacity and shortages for many core firms, but also non performing assets (NPAs) accumulating in the hands of the commercial banking system through the failing ancillary industries. But these effects were felt later. Initially, there was a positive expectation for the industry and that accelerated the growth process.

The real growth rate to the extent that it was supply side induced, required a parallel financing plan. The entire financial mechanism had to thus dovetail the requirements of the five-year plans. As an economy embarking on a highly ambitious development plan, with emphasis on the accumulation of the stock of capital and modernization, the ratio of savings to the Gross National Product (GNP) was grossly inadequate. Between 1951 and 1955, savings to GNP ratio was 6.14 per cent, which had increased to 9.29 per cent during the 1961–1965 period (note that later periods generated a much higher ratio and it was on the investment front that inadequacies could be found). While the growth rate of this ratio was high, it was yet to reach the 15–18 per cent range, which would be deemed comfortable for the plan of industrialization. But the low level of per capita income would not allow that and whatever increment was to be found must be credited to the financial system, with commercial banks playing a major role. One must note though, that a lot of these savings were forced savings, induced through inflationary financing of the government deficits.

The public debt was generated by government borrowing from the Reserve Bank of India and through external borrowing. The market for government debt was not well developed, the yield on government securities being small. The Central Government also relied on the postal savings system which afforded tax advantages to small investors. However, the quality of service offered to customers by the banking system was much higher and the public preferred commercial bank deposits to postal savings in general. The government was spending a lot of money on capital expenditures through financing new plants, construction, equipment and inventories. The financing was done directly through the Central Government budget and through the development banks. This freed resources for the commercial banks to finance working capital in production and to finance wholesale and retail trade. Since the government was mopping up surpluses in a big way, the share of commercial banking in total financial assets declined somewhat. This is consistent with the observation that banks play a more important role in the early phase of industrialization while the securities market and other financial institutions develop slowly in the initial stages and contribute relatively more in the later stages. In the first two decades since 1950, the commercial banking system played a more active role in the process of growth. The banking system raised deposits from the household sector, particularly the middle class, through providing quality and orderly customer service, through cultivating relationship with customers in personal and informal ways, and by providing the assurance that deposits were safe, that banks could meet the deposit liabilities anytime the customer wanted to liquidate his or her savings. Banks kept a part of deposits as reserves and statutory liquidity base, and screened loan applicants of all kinds. Advances were made to borrowers whose past records were good, who had enough assets to pledge as collateral and whose future cash flow situation looked good. Considerable efforts were made in making advances properly and as a result of the above mentioned factor, the loans and advances were biased towards established firms, which were already large in terms of assets and which had a large market share—this was the general pattern of financial intermediation. The household sector led the savings efforts of the economy. The increased preference for liquidity and the speed of the monetization of the economy is evident from the fact that the ratio of financial to tangible assets of the household sector increased from 50 per cent to 92 per cent during 1950 and 1969. This is a remarkable accomplishment of the financial system as people moved to deposits from land and other physical assets. The financial system was thus able to deliver the liquidity, safety and the insurance needs of the people and thus also monetize a larger part of the economy, paving the way for further development.

With the emphasis on planning, the public sector came to occupy a prominent position and requirement of finance on a large scale (Goldsmith 1983).

> Of the 35,000 companies operating in India in 1973, four-fifths were private and one-fifth public. Their inter-relationship, however, in terms of assets, were quite different. Public (that is, not closely held) companies had nearly two-fifths and private companies more than three-fifths of the paid up capital of all companies and the average paid up capital of public companies was Rs 30 million; 25 times as large as that of private companies. The main change that has occurred since independence is the sharp increases in the share of government companies and a less pronounced rise in the share of the foreign companies (Goldsmith 1983:201).

Since the enactment of the Banking Regulation Act, 1949, the policy relating to licensing of banks had been contributing to the growth and strengthening of bigger banks. This was further facilitated during the first half of the 1960s through a policy of amalgamation actively pursued by the authorities. The policy of purposive consolidation pursued by the banking authorities led to a series of mergers in the banking industry during this period. While improving the stability, these had several adverse indications as discussed further. To be precise, it can be said that the development of the big banks was not in the direction that would be conducive for the major proportion of small borrowers and deposit holders. In this background, one must acknowledge the role of UBI as the biggest commercial bank in the eastern region. The pattern of growth of UBI was sensitive to the needs of the small man—this was precisely the reason that it stands out in a positive way among all the big banks.

The process of consolidation resulted in the strengthening of the larger units, with considerable decline in the share of business of small banks, virtually all of which was non-scheduled. During the period 1951 to 1969, the elimination of small banks and the preponderance of bigger units narrowed the institutional basis of the financial structure and limited the range in a variety of banking services.

The decline in the number of borrower accounts during April 1961 to March 1967 is particularly significant. The decline was particularly marked under personal accounts, commerce and agriculture. At a time when the needs of the growing economy pointed to the urgency of the banking system growth covering a wider and diversified set of borrowers, the decline in the number of borrower accounts is perplexing. Data on commercial bank loan advances as outstanding on 31 March 1967 reveal that 81 per cent of the total borrowing accounts were for an amount of Rs 10,000 but constituted only 3.7 per cent of the total bank credit. Then, on the other hand, only 437 accounts out of a total of more than one million account for as much as a 23.4 per cent of the total bank credit. Alternatively expressed, 19 per cent of the borrowing accounts claimed 96 per cent of the total bank credit. The big banks, because of the resources and connections with bigger industries, were in a position to offer facility which is suitable for the increasing requirements of our industry. While undoubtedly the requirements of our industry would need to be met, the exclusive growth of large banks seem to have resulted in the narrowing of the range of facilities available for industrial and non-industrial borrowers, other than those belonging to the large organized sector.

The Rural Banking Inquiry Committee recommended a target of 274 branches to be opened by the Imperial Bank during the five-year period from July 1951. It also noted that the inadequate coverage of branches in the rural areas was a big problem for the economy. The committee took note of the development affecting the stability of the banking system and one of the steps recommended by a stabilizing the situation was that of conversion of non-bank treasuries into bank branches. However, despite all this, only 63 branches were opened 'because of their poor banking potential'. The number of offices of scheduled commercial banks marginally increased by 2,765 in 1950 to 2,858 in 1955. During the same period, the number of non-scheduled bank offices declined from 1,545 to 1,142. However, from 1956 there was a shift of emphasis—the banks which had in the meantime acquired licences were permitted by the Reserve Bank of India to open new branches on a liberal basis.

That said, it should be mentioned that the proportion of banking offices in rural areas was rising and that in urban areas was declining. However, such a shift was not accompanied by a rise in the number of borrower accounts and a smaller average account size due to a number of reasons—first of all, banks did not go for deposit mobilization and lending in a big way, but carried on the orthodox passive urban style of banking in the rural areas; second, rural branches were seen as conduits for mobilization of resources, which could be remitted and employed in urban areas, instead of lending in rural areas which had poorer security and collateral provisions. Thus, the relative scarcity of funds between rural and urban areas rose, and made matters worse for development. Last but not least, was the liberal wages and working condition award to rural branch workers of banks, which led to a tendency to keep the level of rural operations low. B. K. Dutt and others advocated unit banks which could counter this tendency to remove the disparity in the credit situation, fostered by the perverse incentives of banks to move funds from rural to urban areas. However, the unit banking concept did not sit easily with policy making, where branch expansion of the scheduled commercial banks was already underway. A reasonable compromise came with the concept of lead banking in the wake of nationalization, as we shall see in the next chapter.

To summarize, the banking sector reaped the initial gains from industrialization through planning and the forced savings strategy pursued by the government, but became more and more irrelevant to the small saver and borrower, and the agricultural sector. The years of private banking could thus cater only to a part of the economy and left the others to fend for themselves or be rescued by the subsidy propensity of the fiscal system.

The UBI Plan for Banking

To the extent that the UBI did not fit into this unfortunate pattern, one can ascribe its evolution to a different philosophy and vision that the bank's top management had on banking. This was crystallized in a series of documents later published under the title 'Banking Plans'.[1] 'On the Necessity of a Banking Plan' was one of the earlier documents which attempted to explain the banking sector's role in the context of the socio-economic objectives of development and analyzed the special role that banking was to play vis-à-vis the entire gamut of financing institutions that could finance the process of economic growth.

B. K. Dutt (1968) defined the role of banking in the post-Independence era succinctly:

> A successor to a colonial type of economy, India is undergoing an experiment in democracy. The experiment is inspired by the hope that along with the material progress, a balance in human relations would also be achieved and maintained with the consent of the people and that subversive elements would thereby remain under control and people in general will be contented. To achieve such a balance, a programme for the development of the economy is needed. It is in this context that the banking system needs to make its full contribution. It will have to conform to the requirements of the changing social system and the national economy as it emerges out of its colonial form. If the choice is to be to let things take their own shape under pressure of the forces reacting on the economy then the banking system, insofar as it is privately owned, may lose the initiative it still has and might continue to have for sometime. The banking system can hardly do no worse than lose the vigour of its initiative, because the private sector will be as strong or weak as the banking system will be. As such, it should be considered an urgent duty of utmost importance to have a banking plan and execute it expeditiously.

Dutt's vision thus was about managing a contradiction between planning and markets—banking had to dovetail and be guided by the Economic Plans and yet needed to operate as a catalyst for the growth of the free enterprise system. The fundamental need for the growth of banking arose from the fact that monetary resources of considerable magnitude were required to achieve the objectives of economic growth, stability and poverty reduction.

The basic options for resource mobilization were identified as the following:

(*a*) The government can float new loans to the extent the Plan requires, instead of frequently looking to taxation measures or undertaking excessive deficit financing.
(*b*) The private sector raises additional risk capital, long-, medium- and short-term finance from the market.
(*c*) Deposit mobilization by the banks take place at a high rate.

The fact that taxation and the monetization of budget deficits were unsustainable choices was clearly recognized by Dutt and his colleagues and they focused on the government borrowing programmes. Dutt argued that the real success of new floatation of government securities depended on their marketability. Marketability had to be so improved and organized that before a new floatation became due, a substantial part of the outstanding public debts needed to be retired to keep the securities market in an active state. It meant a considerable enlargement of the clientele for such securities all over the country, extending beyond the organized buyers and sellers. In order to ensure that banks like the UBI did not lose out from public borrowing programmes, Mr N. N. Law argued that banks should be used as the agencies through which old public debt could be liquidated and new public debt mobilized. Mr Law also argued for a wider implementation of the deposit insurance system so that small banks could prosper; efficient capital restructuring through both profit accumulation by banks and the development of a liquid and broad based security market where bank capital could be traded. The basic condition that had to be fulfilled, according to them was that of monetary stability and stability in the growth of public debt.

Regarding the growing needs of the private sector, the market for equities and bonds would have to be similarly extended through proper organization. 'As to long and medium term finance, it is apparent that there is lack of appropriate organizations and it has to be organized, either within the private sector or by government. But in its own interests, such organizations should be developed within the ambit of the private sector, of course duly coordinated as far as possible with the ICICI, IFC, LICI and State Finance Corporations' (Dutt 1968). An extremely interesting insight was Dutt's comment—'The conventional view that banks should not engage in long term finance should be re-examined.' History tells us that usually financial markets develop after the banking system and, therefore, in the early stages of development, banks can play a role in fixed capital formation (Cameron 1967). If one goes though the financial statistics of the period, one can clearly see that the market for government securities as well as that for private bonds and shares were extremely thin and lacked adequate institutional support (Goldsmith 1983). The remedy, according to Dutt, was in the necessity

> ...for the banks to get together to decide upon an appropriate policy and if necessary, create appropriate organizations for providing long and medium

> term finance. The private banking system will require to coordinate its programme with that of the nationalized and State sponsored credit agencies. It will also be necessary to persuade the government to leave with the private banking system part of the funds raised through taxes, loans, postal deposits and so on, till they are used, so that the monetary position of the private credit system may not be intermittently disturbed and also in order to provide an incentive to banks in actively sponsoring sales of Governments obligations to small holders (Dutt 1968).

Dutt, Law and others were quick to realize that as long as returns and security were more attractive in urban areas and as long as there were considerable operational and fixed costs in expanding rural operations, credit would mainly be concentrated to trade and industry of the urban centres and deprive the rural areas of their growth potential through systematic migration of funds. They sought an institutional structure that could counteract this tendency of the banking system. Dutt's plan was for a territorial organization of banking, aimed at opening at least one banking office at every marketing centre and at each place with a population of say 3,500. The available statistics indicated the demographic and economic importance of each place and enabled a provisional list of priority areas to be drawn up. A suitable five-year programme could therefore, be prepared on the lines indicated further and designed to open 1,000 new branches each year:

(*a*) Major banks to be asked to select such places as they would like to cover by setting up branches.
(*b*) Smaller banks operating in the neighbourhood may be asked to extend to places not covered by major banks directly or indirectly.
(*c*) For the remaining places, unit banks may be formed by larger banks as their subsidiaries. Places with population of say less than 3,500 were to be left out to be mainly covered by cooperative credit societies and the postal system. 'The risks of finance in a changing economy are likely to be more pronounced at smaller places. Long-term credit fund and stabilization fund set up by the Reserve Bank of India (RBI) represent an attempt to deal with these risks, as far as state sponsored credit institutions are concerned. If similar measures for covering risks could be evolved in the private sector, in the form of insurance against loss from flood, cattle mortality, crop failure and so on, the commercial banks may also profitably

> extend their lending operations to places with low population, either by direct or indirect participation. The territorial coverage of the banking system should not only be extensive but also intensive—banks would be expected to cover as large a section of the community as possible and particular emphasis has to be given to the lower income groups' (Dutt 1968).

The plan of expansion naturally involved problems of personnel organization. The commercial banks at that time had about 60,000 to 70,000 workers. Dutt pointed out that a process of mechanization may make it possible to release a certain percentage of the existing staff to form the nucleus for manning the expansion.

> It is true that such mechanization has to be properly phased. Yet, mechanization can be carried through fast enough to commence the release of necessary personnel within a period of say not more than 18 months from the commencement of the plan of mechanization. It will however, evidently remain necessary also to augment the staff by new recruits and courses of intensive training to the cadre of officers have to be imparted by the banks (Dutt 1968).

But the biggest obstacle to sustainable growth could be the attitude of the labour, as Dutt anticipated correctly. Therefore, his plan called for a Development Pact between labour, management and the owners.

> It is evident that the successful execution of a bold and imaginative plan will not merely depend on an efficient staff and trained officers, but will also require a cooperative outlook of the rank and file. In this connection, a review of labour relations might show that the bankers had for sometime past been exclusively preoccupied with the task of handling labour problems. The resulting distractions naturally prevented them from giving adequate thought to the necessity of planning future progress of banking. But the situation however inconvenient, should not deter bankers from planning ahead. Moreover, the cloud may not be without its silver lining. There is a growing realization on the part of the labour that their prosperity is bound up with that of the institutions they man and the people they serve. It may therefore be possible to evolve an understanding with labour, based on a consideration of the developmental needs of the larger economy. If necessary, the assistance of national leaders may be invited in the formulation of a suitable pact. Sectional outlook on either side must in any case be subordinated to the larger social interests (Dutt 1968).

Even 50 years later, this passage seems just as relevant and important. While this is an incontrovertible proof of Dutt's power of analysis, sadly it is also because Indian policy makers in banking have completely failed to resolve this problem during the first five decades after Independence.

Takeoff to a new Period of Growth

The merged bank had its own growth ambitions, but first it had to take care of the restructuring needs. As mentioned in the previous chapter, the problem of bad debts was one which required priority attention and the advisor appointed by the RBI, Mr Laughland (who came from the Imperial Bank), was assigned the unenviable job of handling it. During 1953–54, Mr Laughland was assigned to look after the branches department. Laughland was respectful of individuality, earnestness and industry shown by the employees of the bank. Mr G. D. Lahiri, a long time employee of the bank, remembers an incident when Mr Laughland had stopped discretionary lending by the branches asking for review of all loan accounts. Mr Lahiri, who was looking after the Kodarma Branch which financed mica exports, wrote a protesting letter. Mr Laughland agreed to meet him and discuss his problems. On meeting Mr Laughland, Mr Lahiri explained that stopping discretionary lending would put mica finance by the bank into jeopardy. He was disturbed over this measure taken by the Head Office and asked Mr Laughland, 'Am I a receiver?' He asked for special permission for discretionary lending to be continued by his branch. The conservative Mr Laughland replied, '...you people create bad debts, how can I give permission?' Mr Lahiri explained that such bad debts in his branch were there prior to his taking charge and that it would be impossible to run his accounts without the permission. Mr Laughland was impressed by the forthright manner and incisive arguments of Mr Lahiri and gave licence for some amount of discretionary lending to him. Branch rationalization was another restructuring objective—though after amalgamation, deposits increased by no less than Rs 2.86 crore, the previous 144 branches had been reduced to 109 (*Capital* 1951: 765). Consolidation of balance sheets and standardization of forms and procedures were also carried out as part of the necessary restructuring exercise. In order to increase the degree of liquidity and as a result of the Banking Tribunal award on wages and working conditions, the bank had a lower earning in 1950 than the combined earnings of the four banks prior to consolidation in 1949.

Once the initial process of consolidation was over, UBI started giving thoughts to expansion. Both deposits and advances grew significantly at annual average rates of 22 per cent and 29 per cent, respectively. Growth was slow in the 1950s, but had picked up by the beginning of the 1960s, and the latter half of the 1960s witnessed very high growth in the assets and liabilities. During 1957–68, the number of branches in India increased from 84 to 164, that is, on an average seven branches were opened annually. In order to be able to build up its image, efforts were undertaken to widen the bank's branch network, so as to cover metropolitan and urban areas in different parts of the country. The bank also went in a big way for the accounts of well-known houses of such metropolitan areas as Bombay, Madras and Ahmedabad. Once the bank could circulate the list of its clientele which included the names of big all-India business houses and once the well known people of the metropolitan and urban areas started speaking well of the bank, people came to hold a high opinion about the bank. Hitherto, even the big companies in Calcutta managed by local people hardly came to local small bank like UBI.

An event worth recording here is the amalgamation in 1961 of two banks, Cuttack Bank Ltd established in 1913 and Tezpur Industrial Bank Ltd established in 1922, with the UBI. Business began to grow rapidly particularly after 1960. Deposits increased from Rs 38.4 crore to Rs 51.7 crore between 1957 and 1960. By 1965, UBI's deposits crossed the Rs 100 crore mark. At the end of 1969, deposits stood at Rs 168.3 crore. As far as advances are concerned, during 1957–60, there was an increase of Rs 8.0 crore—from Rs 23.6 crore to 31.6 crore. Advances more than doubled between 1960 and 1965. At the end of 1969, advances stood at Rs 118.01 crore. The advance–deposit ratio moved up from 61.5 per cent in 1957 to 69.2 per cent in 1969.

The rapid expansion came about as a result of concentrated efforts at developing UBI as one of the major financial institutions of a country committed to planned economic development. Since the very beginning, UBI was conscious of the role it was required to play in the service of the nation. India was on the eve of launching its first five-year plan—and the unified effort of the constituent units of UBI towards consolidation and expansion of the banking industry came as an appropriate precondition for the success of new ideas and policies of the planning era. If the amalgamation of UBI and the beginning of the planning era were not an organized synchronization, it was nevertheless significant. The subsequent developments—the fast growth of UBI's deposits, allocation of credit to an increasing number of productive sectors, expansion of the network of its branches and widening of the range of services offered to the people—show how UBI has been remarkably alive to the important issues of national economic policies and the importance it attaches to the service of the nation.

When UBI was formed, 27 of its branches were operating in East Pakistan (now Bangladesh)—13 of these branches were closed in 1951 and in 1954 another branch was opened, thereby taking the number of branches in that country to 15. Despite heavy odds and recurring crises, the personnel in these branches courageously stood their posts and rendered efficient service. These branches continued to render useful service to the community there till 1965, when they were taken over by the custodian of the enemy property appointed by the Government of Pakistan.

With a pronounced expansion of the bank's business in the 1960s and in the context of the responsibility assigned to banks in the planned economic system, the need for undertaking appropriate orientation of bank-men and for developing a suitable organization could not be overemphasized—UBI has always been conscious of this need. For the purpose of modernizing and further developing its training system, so that the personnel were able to cope more effectively with problems of expanding business with its ever-increasing complexities, a staff training college was set up by the bank in 1964 in Calcutta. The Department of Credit Information was established at the Head Office in the early 1960s. The department was equipped to investigate and evaluate the creditworthiness of UBI assisted business firms and formulate first-rate opinions on the business conditions of such firms with which UBI had no direct dealings.

In its endeavour to accommodate the financial needs of small-scale industries which have an important role in India's economic development, a department was also established at UBI's Head Office during this period, to carry on research on the problems and prospects of small industries. A Department of Economic Studies was also set up to study various banking and general economic problems of the country, to maintain contacts with different economic research institutions and representatives of trade and industry and to provide detailed and updated information regarding the market behaviour of different industrial products.

Though the bank could have acquired the status of a *national bank* during the period, this was not to be. B. K. Dutt knew that the best bet for ensuring fast and sustainable growth would be to have a clear regional focus. There were important reasons behind this strategy. First of all, the bank management was familiar with the conditions of eastern India. Also, Bengal witnessed industrialists (many of them Marwaris) coming to Bengal to take over the British Managing Agency Firms in tea, coal, engineering, agro-products, and so on, while Bengali entrepreneurs were emerging in chemicals, pharmaceuticals, cosmetics, textiles, and so on. The rural–urban trade flourished and opened up the lucrative business of trade finance and bill discounting in a big way. While the labour problem was gradually taking a dismal shape, it was far better than what was to be witnessed in the post-1970s period. New industrial belts like Durgapur beckoned financiers and the Port of Calcutta was still engaging in a reasonable amount of trade with its foreign counterparts. There was a clear need for a Bengali bank which the local community would trust and feel safe with. On the other hand, some socio-economic reasons seemed to discourage the strategy of spreading the bank's wings and land up in far-flung areas. The most important was that the local community of each region preferred to deal with local bankers of the same background because of the familiarity factor and because there was also a degree of xenophobia in the mindset of most of the communities. Formation of networks, which was the key to growth and profits, was the easiest within communities. Also, Bengalis were not spread out in other states in commerce like the Punjabis, Marwaris, Parsees, and so on, and therefore the pull from the non-resident community necessary was largely absent in most of the states. From the Minutes of the meeting of Board Directors, we find a discussion on opening a branch in Allahabad. It was decided to postpone the opening of the branch due to anti-Bengali feelings there. Allahabad had a sizeable number of well-to-do Bengalis living there but this, though necessary, was not a sufficient condition to make the bank management confident. In other places like Mumbai, Chennai and to some extent Delhi, the situation was even less conducive. Yet, there was economic future and insurance in diversifying the portfolio to other states and Mr Dutt set out to conquer selectively the different industrial and commercial hubs, while both extensive as well as intensive efforts went on to develop assets and liabilities within the eastern region.

Dutt was well known in the banking circle and he tried to use his good name to establish the presence of the banks in other major metropolitan centres of the country. His efforts were more of a sporadic nature and not a part of a comprehensive plan of diversification over other parts of the country. His vision was that UBI would be an *icon* of Bengal, and the eastern and north-eastern regions, and, being known well in that capacity, would also diversify selectively in terms of geographical coverage.

Photograph 3.1 Shri Bata Krishna Dutt

Source: Dutt 1994.

Note: The above picture is of Shri B. K. Dutt, Former Chairman and MD, United Bank of India.

Since the Bengal and the eastern region were doing quite well, one can understand the strategy of becoming an *icon* of Bengal in particular, and the eastern and north-eastern region in general. In that, the bank was quite successful, as it became known as the 'Bengali bank', 'tea bank', and so on. As it reached a successful stage, millions of depositors found the bank's large size as a safety cushion indicator and the quality of service being good making the anxious depositor comfortable to deal with the various operations from account opening to money transfer to availing of loans and so on. All these were instrumental in persuading them to invest in deposits with the bank. On the borrowers' side, the bank gave standard facilities like overdrafts, bill discounting, and so on, with ease, while it also provided tailor-made services to individual borrowers like commitments, refinancing and different working capital provisions.

Photograph 3.2 Headquarters of the United Bank of India

Source: Dutt 1994.

It should be mentioned here that even the limited extent of geographical diversification that was achieved under the leadership of Dutt proved to be a significant beginning and acted as a strong foundation for the future growth of geographical diversification. However, the leadership after Dutt did not have the same charisma, foresight and dexterity to handle such a complex growth process. Top bank management became more engrossed with day-to-day operations management. One factor was the deteriorating industrial relations. Another factor was the pressure on organizational aspects of handling growth of fairly high order. The bank never really invested in the capacity to be widespread in its coverage. Ideally, this should have happened when the decline of the Bengal economy started in the mid-1960s in the wake of industrial sickness and militant labour unionism; we shall come back to this point in subsequent chapters.

In the post-merger period, the growth of UBI outside eastern India to a large extent can be attributed to the growing influence of Mr B. K. Dutt in the banking and industrial community. In 1953, Mr Dutt was appointed as a member of the Committee for Finance for the Private Sector with A. D. Shroff of the Tatas as the Chairman. Arun Chandra Guha was the then Deputy Finance Minister under C. D. Deshmukh (who was affectionate to Mr Dutt) and Rama Rao who was the Governor of the Reserve Bank. Between them, they arranged the appointment of Mr Dutt to the committee. In Mr Dutt's words, 'That probably led to the United Bank turning the corner.' Mr Dutt was reminded by Mr Deshmukh and Rama Rao that he had talked a lot about banking in the past and now he had to prove that his appointment was justified.

Mr Dutt was able to form an impression on the committee and particularly Mr Shroff in the very first meeting of the committee. A questionnaire had been drawn up by the Reserve Bank and A. D. Shroff and it was circulated among the committee members when the first meeting commenced. Having had a look at it, Mr Dutt mentioned, in his usual frank and uninhibited way, that the terms of reference were narrowly interpreted. At that point, Mr Shroff, who saw Mr Dutt for the first time, jokingly remarked, 'You must have brought a set of questions yourself.' To everybody's surprise, Mr Dutt produced a set of questionnaire on the table. Shroff went through it and then quietly said that the morning session was over. As the meeting progressed, Mr Dutt had a growing appreciation from Mr Shroff and the latter dealt firmly with those who did not behave well with Mr Dutt. Later on, he and his wife would have dinners with Mr Dutt and showed deep affection and intimacy towards him. The recognition Mr Dutt received in the committee and A. D. Shroff's high opinion of Mr Dutt, which he made known wherever he went in the country and abroad, was instrumental in building up Mr Dutt's image and did a lot of good to the United Bank.

As the United Bank grew, a way to support small business was found out. Laughland was then canvassing for lending money to Multani bankers. The phrase, Multani bankers came to be associated with a number of families which originally hailed from Multan but subsequently settled in Bombay. They had devised their own system of lending money with controlled risk and without any security. Generally they lent Rs 5,000 to a party, though a number of Multani bankers could together lend a few lakh of rupees to a borrower. The Imperial Bank and other banks discounted these bills. UBI took to this not only because it was a very good business without any risk, but also because it was a useful system to lend money to small businessmen.

In the matter of bill rediscounting facility provided by the Reserve Bank of India to banks, the RBI officials pointed out that the UBI did not have large and well known customers on its books. Therefore, special efforts were initiated by Mr Dutt to get large and well known accounts in Madras, Bombay, Ahmedabad and elsewhere with great success. This led to UBI gaining some foothold in these cities and ushered in an era where it was truly a national bank and not just a regional bank.

In Bombay, the relationship of Mr Dutt with A. D. Shroff and Morarji Vaidya (introduced by a local businessman to Mr Dutt) helped UBI in securing, for the first time, ties with the Tatas and the Birla group. During the days of the Shroff Committee, on one of Mr Dutt's visits to Bombay, for the first time UBI made a loan to a textile unit belonging to the Tatas. Vaidya also transferred some other companies to Voltas (a Tata group company) and UBI being a banker to these companies, its relation with the Tatas was further strengthened. The Birla connection started with the Hind Cycles which turned out to be a bad account for the bank. Later on, Indian Rayon Corporation, which failed, was handed over to the Birlas by Morarji Vaidya in the interests of the bank.

United Bank went to Ahmedabad with the good wishes of B. K. Shah of New India Insurance Company Limited. B. K. Dutt and his managers got to know Kastur *bhai*, Arvind *bhai*, Rohit *bhai* and others that brought in a good number of accounts. Subsequently, Mr Dutt became a Director of Industrial Credit and Investment Corporation of India (ICICI) at the instance of Kastur *bhai* and K. L. Mitah, and came close M. T. Parekh, the then General Manager of ICICI and now Chairman of Housing Development Corporation of India. UBI got during this time the account of Mr Thackersey and others.

The United Bank of India had a branch in Madras which was the only one in the south. It was not bringing in substantial influence and business and Mr Dutt was thinking of closing it. At this time, he met C. M. Kothari of Madras at the Calcutta Club who was opposed to the idea of closure and offered to make Mr Dutt known to the business community in Madras. Although his efforts did not take UBI far enough, further help was obtained from C. R. Srinivasan, a Director of the Reserve Bank who liked Dutt and organized a local committee of the bank in Madras, comprising of Kasturi Srinivasan of Hindu, T. S. Santhanam of the TVS Group and others. Thus, UBI rose in status and acquired some influence in the city.

In Delhi, UBI got good connection all over. Lala Hansraj as Chairman of the local committee brought influence and business. Utam Singh Dugal developed a close relationship with the bank. At this time, Mr Dutt developed a relationship with Mr M. S. Oberoi and helped to build up his hotel chain. This was the beginning of a long-standing relationship with a very good industrial client and brought UBI continuous business. Mr Dutt was very helpful to the Oberoi group and personally stood by Mr Oberoi in many difficult situations.

Paradoxically, in Calcutta itself UBI faced a lot of difficulties in getting institutional support. Initially, UBI did not get the deposits of Calcutta Corporation despite Mr B. C. Roy's support. Later on, UBI was included as a banker when a person called Dr Ghosh threatened the then mayor of the Corporation, Mr Naresh Mukherjee, that he would expose the wrong way in which bankers were selected by the institution. The UBI also got deposits from Calcutta Improvement Trust and Port Trust with great difficulty.

The UBI always came forward to render assistance to any project which served the common people in Bengal and Calcutta. Bengal Chemical was a pioneer industry financed by UBI; Bengal Enamel, East India Pharmaceuticals, Bengal Immunity were some others. A close relationship developed with East India Pharmaceuticals which was founded by Ashok Kumar Sen. Hirendra Nath Dutta Gupta, Sen's brother-in-law, knew Dutt and this started the relationship. Initially, the firm had no overdraft requirements, but later on the reliance on the bank increased and the bank became the lead banker to the firm. In media, the bank financed Saraswati Press and later the Anandabazar group. Foundries of Howrah and cold storage units (especially for potato cultivation) were financed. The big industrial groups also got their due share of attention. Oberoi, Goenka, Badri Poddar, and so on, were some of the renowned clients. B. K. Dutt specially mentions in his diary his ties with the Oberoi group—'M. S. Oberoi and his hotel chain were built with UBI assistance and the personal assistance of the author—I personally stood by him in difficult situations. He is a very capable hotelier with international status.' Mr S. B. Roy of Oberoi Group used to handle transactions with UBI. He remembers the beginning of this important relationship—'It was the year 1962 when we approached UBI and got Rs 5 lakh sanctioned from the comptroller of advances Rajenbabu.' Initially, the group had hotels in Calcutta and Srinagar. Later, they started to build hotels in other cities as well and UBI used to help with construction finance. According to S. B. Roy, Mr B. K. Dutt had a weakness for Raibahadur M. S. Oberoi because, like his father N. C. Dutta, Raibahadur was a self-made man and he reminded him of his father. He carefully nurtured the relationship and soon all banking business requirements of the group came to be handled exclusively by UBI. The United Bank of India top management also decided to finance engineering firms which looked poised for growth due to the emphasis of the plans on heavy industry. After the merger, Martin Burn became a client. The chief of Martin Burn came in the bank's board. This enhanced the image of the bank substantially and was an event worth celebrating, recalls Ranjit Dutta[2]. Indian Iron and Steel Company (IISCO) was another firm which had UBI as one of its bankers.

The UBI also started coming to the help of troubled industrial units. In the 1950s, a Loan Recovery Department was set up in the bank. All bad debts were centralized. Instead of prolonging litigation, the bank went for settlement of cases. A lot of companies were restructured. For example, with respect to M/s Khas Chinchuria Collieries, a scheme for repayment of banks dues was prepared on the following lines—there was to be appointment of managing contractors by the company under the relevant clause. The managing contractors were to pay owners a guaranteed profit per ton of coal. Amount aforesaid was to be paid by the managing contractors directly to the bank on owner's account, towards part satisfaction of the banks' dues. Managing contractors were responsible for regularly furnishing the bank with a monthly statement of coal raised. Bank was at liberty to proceed with the execution of the available relief in favour of the bank, if clauses were not adhered to. On nationalization, the entire payment of compensation by the government was to be received by the bank.

Since the beginning, tea was one of the biggest clients of UBI. The early experience of Mr B. K. Dutt in tea and the flourishing tea industry of the north-eastern region were the main factors which propelled the bank to tea financing. Although in later years (during the nationalization era) the relative importance of tea finance declined, in the beginning it comprised as much as 30 per cent of the bank's loan portfolio. The tea finance system of the bank was different from the overdraft system. It was a need based system and 100 per cent of the clients' requirements were financed. Mr Ranjit Dutt recollects, 'UBI was specialized in tea long before banks like SBI came into tea financing.' The title 'Tea Bank'was acquired during these early years. The experience of Mr B. K. Dutt in tea financing was recognized nationally and when in 1971, RBI formed a committee on tea, Mr Dutt was made the chairman. Some important clients of UBI in tea were the Kanoi group, McLeod Russell, Dhanseri Comazp, Moran Tea Company, Bishwanath Tea Company and Diana Tea Company. Their growth was supported mainly by UBI.

Let us delve into a bit of statistics to understand the relative importance of tea finance as well as the other core areas where the bank was beginning to make a mark. As far as classification of advances is concerned, the UBI portfolio showed marked concentration in some particular sectors. The maximum concentration was in tea where, in 1960, there were as many as 141 accounts of limited companies. At that time, the total outstanding tea loan was Rs 5,11,38,000. Compared to this, the investment in other industries was small. Among them, cotton textiles stood out as the most significant with 27 accounts of limited companies in 1960 and the outstanding debt on them being Rs 2,66,11,000. Coal and other mining industries were also financed quite heavily and there were 52 accounts of limited companies with the loan amount outstanding being Rs 1,01,47,000. Some other industries worthy of mention were chemicals, vegetable oil, public utilities and light engineering. In commerce, trade of hardware products, machine engineering products and metal products were financed quite heavily in the early 1960s. In the financial sector, dealers in government securities and *shroff*s were refinanced quite extensively and there were 61 *shroff*s in the account of UBI in 1960. The UBI being very much a representative bank in the eastern part of India, the description of the portfolio, though short, should indicate the nature of industrial growth and the pattern of commerce of the region. The balance sheets of the initial years after the merger do not reveal the sectoral allocation of credit sanctioned and disbursed by the bank. However, those of later years do indicate the broad patterns. Some data on sources of funds are also available. Most of the deposits (70 per cent in 1965) came from personal rather than institutional and government savings while the average for other scheduled banks was 52 per cent. As discussed earlier, this was a reflection of the confidence that the average Bengali household had on the bank. As far as the use of funds was concerned, around 70 per cent went to industry, around 18 per cent to commerce and around 7 per cent to agriculture, in the late 1960s. The UBI portfolio had a greater concentration on industry than the average scheduled bank of the time but a lower emphasis on commerce. There are two interpretations of this data. One is that UBI was a bank that made a bigger relative contribution to industrialization while allowing trade to be financed by the unorganized sector and some institutional agencies, while the other is that UBI grew by catering to the primarily rich and powerful industries. However, while the second argument looks easy to dismiss in the context of the small average account per industrial borrower, it is true that the absolute amount lent to small-scale industry was small by any standards. This and the low level of agricultural lending were undoubtedly some typical features of the commercial bank lending of the times and the bank hardly looked like the same bank which had advocated the concepts of socialization of banking, community finance and unit banking in different regions. In defence of the bank, one may say that the initial banking plans were never accepted and the bank developed through the natural tendency of seizing opportunities of establishing profitable branches within a broad geographical area. Dutt did try to establish a unit bank in Assam but the attempt was thwarted by powerful political forces.

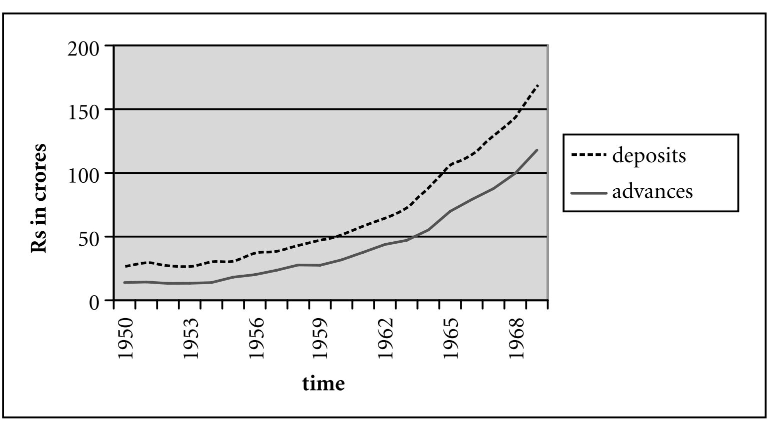
Let us now take a deeper look at the growth pattern exhibited by the bank. We focus on the following issues:

(*a*) How fast did the bank grow and whether this was a sustained pattern from the beginning to the end or marked by heavy fluctuations?
(*b*) What the growth pattern implies for the incomes and profitability of the bank?
(*c*) What was the risk exposure of the bank on the assets and liabilities sides?

The growth of a financial intermediary, like a bank, signifies that savings are being allocated to investments at a high rate. There are some significant obstacles to growth in advances, namely, the fixed costs and the variable costs of banking business (which determine the loanable funds to deposits ratio), the attitude and risk aversion of the bank in setting the terms of a typical loan contract (with respect to upper limits on amount sanctioned, security requirements, interest rates, and so on), and the regulatory liquidity requirements which determine the actual advances to a client. When deposits to loanable advances ratio is high due to high establishment costs in banking, the growth of advances become constrained. The growth of advances also become limited when the bank, on account of its inherent conservatism or due to prudential regulatory liquidity norms, exhibits a tendency to ration credit within and across groups of borrowers.

Figure 3.1. shows the growth of advances and deposits over the two decades.

Figure 3.1 Growth of deposits and advances



Source: Annual Directors' Reports, UBI.

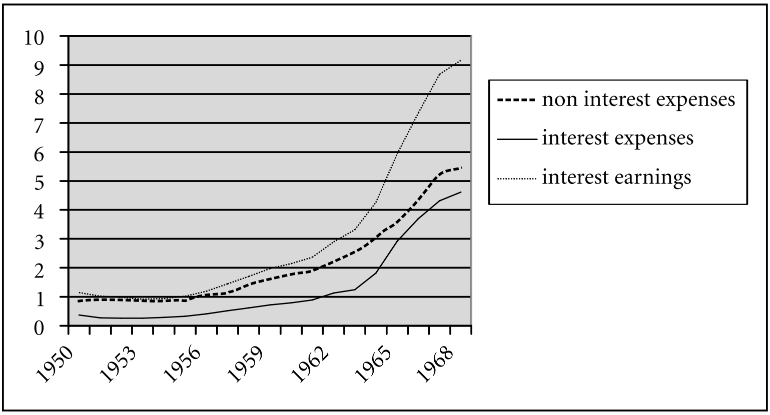
As compared to the first decade, which saw reasonable but moderate growth, the 1960s reveal a sustained acceleration. The business opportunities seem to be multiplying for UBI and one wonders at the essential causes. The growth of manufacturing industries in the wake of five-year plans can be attributed as one of the factors. The state of West Bengal was still growing at a high pace despite the adverse comparisons with states like Maharashtra and the imbalance in the regional plan outlays. On the liability side, rapid branch expansion was taking place in the mid-1960s, and together with the changed liquidity preference and savings habits,[3] the lack of strong competition enabled the bank to mobilize deposits at a high speed. The interesting thing is that the rapid growth took place despite the moderate interest rates prevailing. Thus, the bank's individual demand and supply schedules of funds seemed to have a very low interest elasticity. Rather, the income elasticity of demand is high, whether by income one means average income of the depositors or the borrowers, or the average per capita income of the eastern region. It should be noted that the mid-1960s saw a period of sluggish growth compared to the earlier years of the decade but the growth rate of the earlier years was soon revived and, in fact, UBI had the highest rate of growth on the eve of nationalization. The role of the employees in the growth process cannot be underestimated—they worked tirelessly in mobilizing deposits, managing funds, keeping accounts and evaluating loan proposals. The deposit per employee and the advances per employee increased and complemented the branch expansion and enhancement of the organization's capabilities in lending to diverse industries. However, the industrial relations remained somewhat poor due to the militancy of the trade unions and the presence of a sizeable fraction of the labour force engaging in tactics like go slow, work to rule, and so on, while the remaining workforce remained productively engaged.

But merely satisfying the high growth condition does not mean the financial intermediary or the financial system that it represents (however imperfectly) is efficiently discharging the process of allocation of resources under uncertainty. A necessary condition (though not sufficient) for this is profitability. Profitability implies that the financial intermediary, like a bank, is efficient in what it is entrusted to do and profitability implies the creation of a surplus that can be used to augment the financial and economic growth process further. However, profitability derived from a monopoly or monopolistic position that a bank has does not imply increase in efficiency. Thus, a sufficient condition for profitability to be an efficiency signal is the competitive market structure. For a short period, as we are considering here, we take the degree of competition to be given by the institutional constraints operating in the banking industry, and offer our hypotheses and shall construct our arguments accordingly.

There are other signals of efficiency in banking industry other than profitability such as the liquidity provision, term transformation, risk taking, risk sharing and risk management. However, as we shall argue here, the provision of these services and functions are intimately connected with profitability.

The money market tightened in the 1960s leading to higher interest cost and earnings. However, the earnings were often booked income and not actual cash inflow, while the expenses were always actual outflow. As a result, the reliance on call money market interest rates (which were quite high) increased. The earnings and income growth also accelerated from the mid-1960s and the growth pattern of non-interest expenses show a high degree of convexity in the high growth phase. This obviously implies that the bank can be deemed to be a good employer as well as having very high incremental costs in the path of expansion. Note that the differential between interest earnings and interest expenses could contribute to significantly higher and growing profits but for this phenomenon (see Figure 3.2). Fixed costs were high due to several reasons. One was the lack of adequate mechanization in banking operations that necessitated high transaction costs in terms of time devoted to business process management by the bank staff. Although Dutt had a vision about mechanization, it fell way short of implementation in terms of cost minimization. Nor were the shareholders able to voice their concerted opinion effectively on the subject. Corporate governance through the Board of Directors was also inadequate in this respect since it gave significant power to the management in such matters. The satisfaction with a low profitability ratio from the early days had an effect throughout the next 50 years, as we shall see in the later chapters. The fact that banking profit was not just interest earnings minus interest expenses and that fixed costs were to be taken seriously in balance sheet appraisal did not receive the due attention from the different quarters of the economy, except some banks like UBI and the government. Another reason was the high wages and salary structures as determined by the different banking tribunals.

Figure 3.2 Growth in earnings and expenses (in Rs crore)

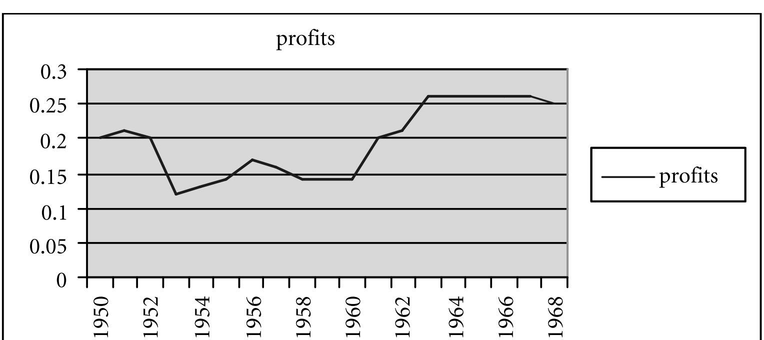


Source: Annual Directors' Reports, UBI.

The Shastry award and Desai award gave considerable pay hike for branch employees in scarcely populated areas and had dire consequences when the branch expansion movement started accelerating in the 1960s (*Capital* 1963: 462–463). Though the government appealed against such awards, it was held as not representing the majority of the banks (UBI being an exception) by the banking tribunal which heard the case. The bank Chairman N.N Law repeatedly pointed to the seriousness of the situation and urged the employees to link productivity with wages. Needless to say, such an approach did not evoke much response from the employees, thus leading to low profits as well as a lower than desired pace of rural branch expansion for the bank. It must be emphasized here that employee productivity was rising as witnessed by the growth of business per employee, however, the growth in establishment costs was higher than this as a result of the above mentioned awards. Initially, Mr Dutt had tried to enforce a clause in the awards which would classify banks on the basis of business per employee instead of total deposits. Mr Dutt's intention was to make wage revision subject to the provision that the ratio of establishment costs to deposits would not be higher than the ratio in the previous period. This could ensure that establishment costs were kept in check, while providing an incentive to employees for better service and mobilization of deposits. However, the big banks opposed and thwarted the move.

As a result, profits remained low at around Rs 20–25 lakh throughout these 19 years and displayed almost zero correlation with advances, interest earnings, deposits, and so on. Noticeably, profits in fact declined from Rs 20 lakh at the beginning of the 1950s to Rs 15 lakh for the rest of the decade. The recovery to a Rs 25 lakh average level came in the first half of the 1960s, but again flattened in the second half despite the sharp takeoff of business. No doubt, the bank tribunal awards of 1950s and the 1960s contributed to higher establishment costs in the form of disproportionately high salaries and allowances, but at the same time, one can conjecture that a significant productivity improvement of the staff which could have had a positive effect on both the wage fund as well as profits was missing. The second factor behind lower profitability was that there was significant provisioning for bad and doubtful debts in the form of liquid investment reserve funds. The third reason was high interest rates on deposits combined with inelastic demand for bank deposits. This evoked pessimistic concerns and apprehensions by the bank management, as in the case of high operational and fixed costs imposed by liberal Banking Tribunal awards. The only redeeming feature was the inter-bank agreement on ceiling on deposit rates in 1958 engineered by the Indian Banks Association, though it was felt by the bank management that the rate was still too high and frequently revised upwards thereafter. A final reason is the low interest rate spread but, as we have seen already, there was a significant volume of business to counteract this phenomenon. The low profits meant the equity base did not improve with implications for the capital adequacy ratio (see Figure 3.3).

Figure 3.3 Profitability (in Rs crore)



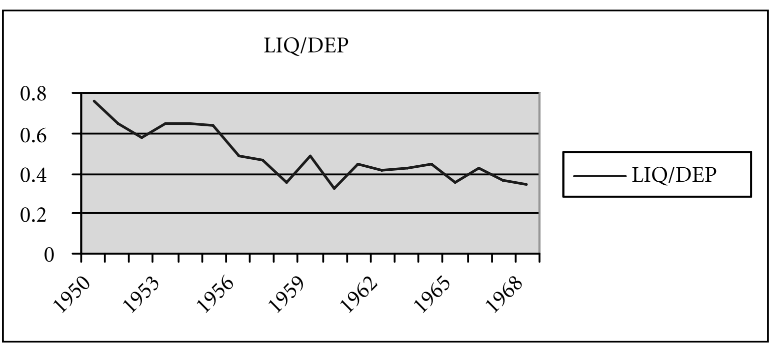
Source: Annual Directors' Reports, UBI.

The bank management repeatedly and routinely ascribed the low profit level due to high interest rates on deposits that competition had brought about and a high establishment cost, that is, mainly the cost of wages and bonuses paid to the labour force. A phenomena noticed by the bank management was that when interest rate on deposits increased, it was followed by a concomitant increase in the lending rate. But the interest rate differential between the lending and the deposit rate did not change since a higher lending rate contracted aggregate income and savings, and led to another round of increase in the deposit rate. Even with the inter-bank agreement on deposit rate ceilings the situation did not improve profitability significantly since the ceiling rate was set at quite a high level and was frequently revised upwards. With the interest differential remaining constant and the establishment costs being quite high, the only way to augment profits was to increase business turnover appreciably, but that meant more intensive and extensive branch banking which would further increase labour and establishment costs and create a vicious circle of low profits for the bank. The other alternative, which was an unpleasant one, was to retrench part of the labour force and increase the mechanization of bank operations. But the bank had never paid attention to the disproportionately high labour force that it had started with and the high rate with which labour had accumulated irrespective of productivity. A bank management, which was averse to taking too hard decisions on labour and a militant trade union, meant that such an alternative remained unfeasible. In comparison, most of the other banks had a much lower level of starting labour force and a lower rate of labour force accumulation during this period, could earn a correspondingly higher rate of profit and declare higher rates of dividend.

An alternative or complementary explanation of low profits is that the bank was behaving as a risk averse financial intermediary, so that the optimal portfolio choice of the bank reflected low returns and low risks on loans on account of the preference for safe projects and mitigating the liquidity risks on the liability side of the balance sheets through maintaining highly liquid asset portfolio. We examine this hypothesis further.

Were there liquidity risks during this period? The deposit growth was accompanied by a concomitant growth in reserves and increase in depositor confidence and goodwill. Thus, while there were banks which failed or brought to closure through runs in the pre-merger period, the bigger size of UBI was a factor which lowered liquidity risk and increased the confidence of the depositors to start with. However, the cash reserve ratio and the statutory liquidity ratio of the period was much lower than later periods, as already discussed earlier, and therefore, one needs to examine whether UBI was facing any liquidity risk. One significant measure of liquidity is cash and other short-term assets, such as call money, but a broader definition would include the investments by the bank which could potentially be used in the wake of any major liquidity risk. Using this broad measure, we find that at the beginning the liquidity–deposits ratio was close to one, but sharply dropped twice in the decade of the 1950s to reach slightly below 0.4 and showed no particular trend thereafter (see Figure 3.4). Further, there were persistent fluctuations during the 1960s and the standard deviation to mean of the ratio (coefficient of variation) is quite significant. One reason behind this was the static nature of the market investments which declined in relative importance as time passed.

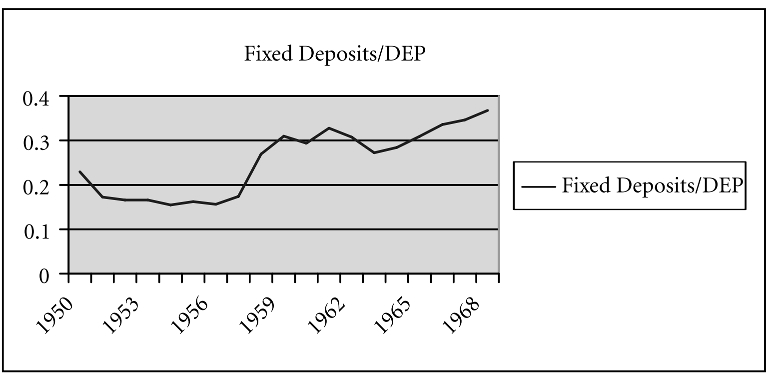
Figure 3.4 Liquidity–deposit ratio



Source: Annual Directors' Reports, UBI.

However, the share of fixed deposits in total deposits increased significantly in the middle of the period and thus a high proportion of total liabilities became of a longer duration and maturity. This countered the liquidity risk discussed earlier. Further, the bank, armed with an increasing share of fixed deposits to total deposit liabilities, could invest in illiquid (long term) borrower projects. Of course, the bank had to set aside some liquid funds in anticipation of early withdrawals or liquidation of the fixed deposits, but despite doing so, the bank had enough funds to invest in project finance (see Figure 3.5). This was an important development in not only enabling the bank to become a true financial intermediary through engaging in significant term transformation, but also in the sense that the bank could potentially earn much more profit through earning high returns on illiquid but attractive projects which it could not afford to finance before. Did the bank actively follow a promotional strategy in fixed deposits from the late 1950s or was it just a result of the shift in the public's preference in liquidity and return? The numerous advertisements that appeared in *Capital* attest to the fact that the bank was indeed promoting fixed deposits in a big way. It must be added that the general public was responding to these advertisements in order to improve the returns from the portfolio of financial assets of high degree of liquidity.

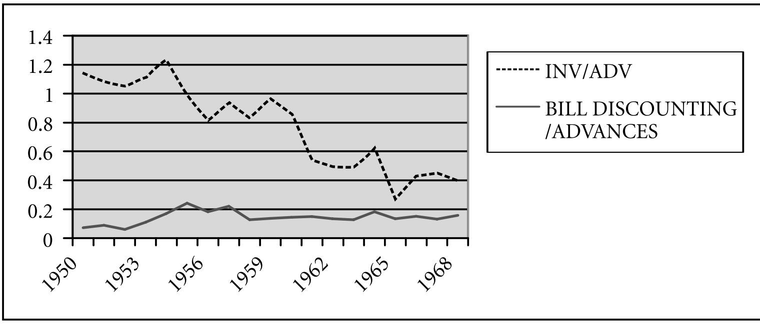
Figure 3.5 Liquidity of deposits



Source: Annual Directors' Reports, UBI.

One measure of credit risk exposure is the ratio between bills receivable and the advances in the form of loans, cash credit and overdrafts. This ratio was hovering around 20 per cent most of the time. This means that the growth of bills discounting and acceptance business was around the same as the rate of growth of advances (see Figure 3.6). Though

Figure 3.6 Asset portfolio evolution



Source: Annual Directors' Reports, UBI.

primarily financing industry rather then trade, the bank was thus keeping a balance between trade finance and industrial finance. In particular, the uncertainty of credit default could thus be countered by certainty of return in the bills business. The liquidity advantage from the bills business as opposed to illiquid industrial loans business could also be leveraged to provide a buffer for liquidity shocks. Investments remained quite static during this period and therefore the investment to advances ratio climbed down sharply. Things changed quite a bit when banks were nationalized and investments became directed in nature, as we shall see later. The credit risk exposure remained low primarily on account of safe projects being chosen in the cream industry of tea, cotton, jute, engineering, publishing, cold storage, hotels, metals trading, and so on. Even those industries and firms which got their proposals sanctioned set upper limits on overdraft facilities well below their total capital requirements. Only tea, as mentioned before, had need-based 100 per cent financing of working and fixed capital.

To sum up, the bank was, on one hand, growing through branch expansion and labour force accumulation in order to gain strategic market share in select industries, clients and regions. This growth process could be termed as risk taking—the bank showed a willingness to tolerate high establishment charges and labour costs in order to increase its stake to corner future profit. On the other hand, the bank was indeed behaving like a risk-averse financial intermediary which was averse to taking hard and risky decisions, in so far as it kept a high degree of liquidity in its operations and in that it chose safe projects while engaging in term transformation. However, the chance to increase profits substantially through term transformation as deposit maturity increased in length was not properly seized upon (the management, predictably, kept complaining of high cost of fixed deposits without explaining the insufficient increase in turnover adequately). To understand where the bank was leading and where it was missing out in allocative and operational efficiency, we have to take a brief look at the comparative picture accounting for the bank's position among other major scheduled commercial banks.

Comparative Performance

In the first half of the period, the bank behaved like a classic example of a risk averse entity. The bank followed prudential banking norms—the ratio of capital and reserves to deposits as on 31 December 1960 stood at 6.86 (a maximum among all banks) as compared to 2.62 for the State Bank of India, 2.02 maintained by the Punjab National Bank and 3.65 for the Bank of Baroda. However, the rapid growth in deposits and advances in the 1960s was not accompanied by concomitant growth in the share of capital which remained stagnant. Economic theory tells us that without significant own capital, a bank generates a tendency to take undue risks in the credit market and such a philosophy underlies the recent Basel Accords. However, in the 1960s, banking was seen as self-stabilizing through internal and external prudential measures. We shall examine the nature of those prudential measures in the next section, but for now, it is important to note that the provision of capital may be largely irrelevant to the performance of a bank, provided the management is honest and competent. What was really disturbing about the stagnancy and low share of capital was not the risks that they implied in banking operations but the negative vote that it implied for the bank from the potential capital providers. The cost of capital for a bank which was earning low profit was always going to be high so as to discourage the bank from going to the capital market at all. In contrast, other banks, which signalled their future profitability through past profitability, could tap capital at attractive terms, thereby enhancing their profitability further.

The regional distribution of deposits was the highest in Calcutta (around 60 per cent), followed by West Bengal (excluding Calcutta) and then Assam, Tripura and Manipur States. Bihar and Orissa (taken together) and Bombay had 5 per cent of the deposits, respectively. Thus, the bank had become one of the main bankers to the eastern and north-eastern region of the country. Establishing relationships with customers and nurturing the relationships to grow the network of loyal customers among the well to do and middle classes was the strategy that the bank followed with considerable success in the large cities such as Kolkata, Guwahati, Cuttack, and so on. Implementation of such a strategy involved a large set of bank agents who would function as relationship managers and the set of bank employees who would be subordinate to such relationship managers. Initially, each branch manager would act as a relationship manager, but gradually the position became specialized enough so as to demand exclusive attention and a special job assignment. Taking advantage of the huge staff size, UBI could effectively mobilize a sufficient number of such agents in each locality or zone. In contrast, most of the other banks had limited staff size and could not invest in relationship banking the way UBI could.

A high personnel–client ratio and a high relationship manager–client ratio meant that the UBI had the potential to augment the deposit base at a fast rate. The fact that the economic condition of the eastern region was good in some of the regions where UBI had invested in terms of dense branch networks, meant that the potential was indeed realizable. This was indeed the case. It is noteworthy that the total demand and time liabilities of the UBI generally rose faster than that of all scheduled banks taken together during the period 1955–60. Between 1955 and 1956, the former rose by 9.21 per cent while the latter rose by 7.77 per cent; in the last two years of the decade, that is, 1959 and 1960, the former rose by 8.52 per cent while the latter rose by 4.98 per cent. As we have noted before, since the mid-1960s the bank had witnessed a tremendous growth in deposits and this was accomplished through an extremely high rate of branch expansion. The rate of growth which was significantly high was that of fixed deposits. This kind of growth was unmatched in the banking industry. In the first step of term transformation, such as deposit mobilization, UBI was thus eminently successful.

The total staff strength was quite high from an early period. For example, in 1959 it was 3,738 for UBI while that for the State Bank was 23,757. Staff per branch was lower for the latter. Some other banks with high number of staff during this period were Central Bank (11,250), Punjab National Bank (10,000) and the Bank of Baroda (3,202). Why did the bank have such high initial staff strength and why did the staff size keep growing at a high rate? Initially the four constituent banks had their respective unions which did not get united through the merger and each of them continuously kept striving for more power. These unions would ensure that the high staff size at the time of the merger would not be reduced through retrenchment. Though B. K. Dutt wanted to reallocate the existing staff to new branches during the process of growth instead of recruiting new people every time a new branch was opened (as he had advocated in the Banking Plans), he was unable to implement this principle in practice. Unions would block relocation every now and then and would actively seek to increase their size and the enrolments of members in new branches. Having said that, one must again emphasize that the bank management was soft with respect to employee relocation versus employee recruitment decision and, at times, favoured the latter explicitly through some ideal notion of a bank as an employment provider.

A measure of efficiency during the early days was the ratio of net profit per deposit. In this, UBI did fairly well initially—in 1959 it had a ratio of 0.32, in 1959 the ratio was 0.29 and in 1960 it was 0.28. Compared with this, the State Bank had figures of 0.32, 0.41 and 0.30, respectively, doing only marginally better. The same could be said of most of other banks (UBI Balance Sheet Analysis 1960). However, the rate of dividend was lower than most of the other banks as shown in Table 3.1 Later on, net profit to deposit ratio fell sharply and arrested any possibility of growth in the dividend rate increase. Table 3.1 gives a comparative picture of the dividend rates for the mid-1950s.

Table 3.1 Dividend rates (in percentage)

Name of Banks	*1955*	*1956*	*1957*	*1958*	*1959*	*1960*
Central Bank of India	12	14	14	14	17.20	18.40
Bank of India	16	16	16	16	16	20
Bank of Baroda		14	14	12	14	17
Punjab National Bank	14	16	20	20	20	20
United Commercial bank	5½	7	7½	7½	11	12
United Bank of India	3	3	3	3	4.30	4.30

Source: Balance Sheet Analysis, 1960, UBI.

It must be noted that the bank could afford to pay low dividend rates despite the low price of the bank's share in the security market due to the fact that shareholders were dispersed and corporate governance was not at its best. Another reason was that the bank did not have to grow through accumulation of its capital through new issue since deposits were growing quite fast. Had there been an adequate concern of the high cost of deposit growth, not only in terms of interest payments but also growing establishment costs, the bank would have been forced to turn its attention to growing its base of share capital. But that would have demanded a greater accountability and a better performance, ultimately manifesting through high dividend rates and high share prices. The bank management avoided the burden of such a high responsibility.

Another measure of efficient utilization of resources or the *x-efficiency* of the bank was the ratio of advances to deposits. As Table 3.2 indicates, UBI's relative performance compared to other banks was reasonably satisfactory on this account. However, it was not as good as that achieved by Central Bank of India though it had a far better utilization of deposits than that of the State Bank.

Table 3.2 Ratio of advances to deposits

Banks	*1957*	*1958*	*1959*	*1960*
State Bank of India	47.32	36.01	28.71	40.29
Central Bank of India	65.53	61.75	66.50	75.57
Bank of India	71.88	66.82	67.47	76.71
Punjab National Bank	54.53	51.67	51.35	67.05
Bank of Baroda	66.24	59.77	62.82	70.85
United Commercial Bank	61.71	57.60	57.07	69.02
Allahabad Bank	56.94	55.28	57.71	61.46
United Bank of India	61.40	63.48	57.71	61.11

Source: Annual Directors' Reports, UBI.

Although, by other measures of efficiency, the bank performed relatively well in the early 1960s, it had a high ratio of establishment costs to deposits, earnings and expenses (Table 3.3). From the early days, there were indications of overstaffing relative to the industry standards and the presence of the strong union movement compounded this problem. The management tried to deal with this issue as best as it could within the constraints imposed on it and given the fact that it wanted to avoid bargaining with labour on this issue.

Table 3.3 Ratio of establishment costs to deposits, earnings and expenses in 1960

	To Deposits	*To Earnings*	*To Expenses*
State Bank of India	1.34	39.60	43.52
Central Bank of India	2.09	32.96	38.66
Bank of India	1.47	27.34	34.04
Punjab National bank	2.19	35.13	40.63
Bank of Baroda	1.61	26.03	28.57
United Commercial Bank	1.73	26.51	30.36
Allahabad Bank	2.01	32.76	34.78
United Bank of India	2.60	50.00	52.94
Dena Bank	1.63	28.00	31.25
Canara Bank	1.62	29.07	32.89
Indian Bank	2.33	32.16	37.39
Indian Overseas Bank	2.21	28.76	35.91
Union Bank of India	2.31	32.24	37.82

Source: Annual Directors' Reports, UBI.

Prudential Banking: Some Examples of Operational Procedures

Banking is a story of careful and calculated risk taking, diversification and specialization, at the same time. It takes some time and lot of management time to really become an expert in financing a particular industry. After financing one firm in an industry, the bank acquires industry specific knowledge which implies that other firms in the same industry can and should be financed. In other words, there exist economies of specialization. In financing jute, tea, coal, heavy engineering industry, and so on, the bank developed the special sectoral expertise. At the same time, in order to protect against industry specific shocks and the general uncertainty—diversification was required. Thus, we find a pattern of risk hedging at the industry level as well as the sectoral level. But what was most important were the innovations in bank operations management to augment prudence, safety and security. Examples of several such innovations are given further. These would have contributed significantly to profitability but for the rising establishment costs.

The bank developed a manual of instructions from the early days so that fixed and efficient rules were uniformly followed by the bank staff in dispensing daily business. The instructions were simple, yet comprehensive, and attest to the detailed thoughts put into operational efficiency by the top management, training personnel, consultants and experts. Here are some examples ranging from forms for cashiers to changes made in keeping records of credit portfolio (moving from a sectoral record keeping system to type of securities), to memos about how the irregularity sheets about borrowers should be kept and managed, and finally about the details of procedures for tea finance as managed by the tea department.

> From the manual of instructions (Organization and Methods Department)
>
> Selected circulars 1960–69
>
> Change in record keeping
>
> Head Office
> To all branches
>
> Jan 25, 1960
>
> Monthly book statements
>
> It has been decided that the present system of dividing your advances accounts into the groups—commercial, industrial, seasonal and personal will henceforward be discontinued. With effect from the month of January 1960, you will instead please prepare three statements every month namely—
> (*a*) loans,
> (*b*) cash credit and overdraft,
> (*c*) bills discounted and purchased.

(The bank thought it proper [rightly so] to make the difference in the financial instruments the basis of classification rather than the type of the user. This would also make transparent the nature of the portfolio held by the bank and the exposures in different types of commitments.)

An important innovation was the review form. The review form eliminated all need for correspondence of the agents to support, extend and/or modify, correspond for further clarification from the Head Office and the inevitable delay in getting decisions from the Head Office.

Agents were advised to anticipate the requirements of their clients well in advance so that frequent change in terms of arrangements may not occur and at least there should be a gap of three months from the date of sanction.

Irregularity Sheet was used to check if anything went wrong. It prevented delay in diagnosing and rectifying of problems. The instructions were pretty clear— 'Irregularity sheet is to be submitted in duplicate every week ... so as to reach Head Office....' Quite a few items came under its purview—return of purchased or discounted bills or cheques, direct receipt of payment of bill purchased by the drawer, relaxation of margin, any irregularity noticed after godown inspection, non-fulfilment in the stipulation or reduction of limit or where the agent feels the account shows signs of major weakness were to be incorporated in the irregularity sheet and so on.

Report on the position of loans and every branch was to be submitted in March, June, September and December. Important canons of control in the conduct of advances in the branch were included in the quarterly report form, with confirmation or certificate which assured control of advances in the branch.

Bank Guarantee (dealing with legal issues in the conduct of banking business) was another area which required delicate handling due to the risks involved. Here is an example—

> To all branches
>
> According to legal opinion obtained by the Bombay Exchange Banks' Association ..., any clause in the guarantee calculated to release the bank from its liability ... must be worded in such a manner as would include 'action' or 'suit' and would indicate release or forfeiture.
>
> Deputy Secretary

In due course, a decision was taken regarding Asking Borrowers for Audited Balance Sheets. 'So far it has been our practice to ask for audited Balance Sheet only from limited companies and not from the firms … It is however,

> essential that in the case of commercial and industrial advances, we should keep a track of business trend of our borrowers. This is necessary due to the following main reasons—
>
> (*a*) If the business of our borrower goes down, we become vulnerable, despite the securities that we may hold.
> (*b*) Some serious financial weaknesses may develop although the business as a whole may appear outwardly to be steady or even showing an upward trend. There may be overtrading, slow realization of book debts, interlocking of funds, over extended position and so on'. [4]

Ensuring security of debt in partnership loans was another contractual innovation which made the client share a significant amount of risks which would otherwise have been shifted to the bank. '... in order to safeguard the bank's position in case of insolvency of the firm and/or of the partners, it is necessary to make the partners as principal debtors for the firm's indebtedness to the bank'.

From Board Meeting Minutes we find the bank was taking suitable Insurance Cover for many items.

> The Board considered the question of obtaining insurance cover for risk of loss arising out of acceptance or payment or collection of forged cheques and drafts and it was resolved that an insurance cover for Rs two lakh against such risks be obtained from Ocean Accident Guarantee Corporation at an annual premium of Rs 23,000 approximately, as recommended by the Executive Committee of the Board.[5]

Cash insurance was taken and continued. 'Resolved that renewals of the under mentioned policies such as, (*a*) cash in safe, (*b*) cash in counter, (*c*) cash in transit, (*d*) fidelity guarantee and (*e*) postal cash in transit for a further term of one year, with the existing insurers, approved' (Minutes of Board Meeting 1950–69).

Recovery of debt from those who defaulted required careful renegotiating with the client. The bank tried to make sure that in such cases the bank had a say in the control of management. Further, contingency clauses had to be provided to share risks optimally.

But the strongest area of bank management remained in the advances to tea estates against hypothecation of tea crops. The main office at Calcutta and selected branches in the tea growing areas were allowed to take up tea crop finance with the previous sanction of the Head Office.

On receipt of a proposal to finance a tea estate against hypothecation of crop, all information sought for in the prescribed application form were to be collected and verified. Balance sheets and profit and loss accounts of the garden for the last consecutive five years to be obtained and scrutinized to ascertain if the garden is running at a profit and the expenses are reasonable.

The bank made sure, before lending, that on the following points it was satisfied:

(*a*) The location of the garden is at a convenient place.
(*b*) There is no difficulty of transport.
(*c*) The soil is good.
(*d*) The condition and age of plantation satisfactory and the percentage of vacancy negligible.
(*e*) The climatic and natural conditions are congenial to healthy growth of tea plantation and the plantations are not infested with mosquito blights or other pests or infectious diseases and there is no common drawback for tea cultivation in the area.
(*f*) The production per acre is not below the average standard of the district.
(*g*) The factory and machinery are well equipped with spare parts for repair, replacement and breakdown.
(*h*) The labour force is adequate and no difficulty is experienced in procuring labour.
(*i*) The quality of tea manufactured during the last three years was good and up to the standard and the average price fetched was also up to the average of the district.

Besides references about credentials from the previous bankers, a reference has to be made to its brokers for verification of figures about tea sold, sales proceeds, quality, average price and the general opinion of the broker about the tea estate.

Accommodation against hypothecation of tea estate is allowed for seasonal purposes only and must be liquidated within the season.

At the time of sanctioning of the loan, the party had to submit fund requirement month-by-month, with the allocations made on the basis of a budget of total expenses for the year as under:

(*a*) Cost of chests
(*b*) Amount of excise duty

(*c*) Cost of food stuff
(*d*) Cost of stores
(*e*) Provision for insurance, rent and taxes including income tax and agricultural tax
(*f*) Reserves
(*g*) 12 months' amount of expenses

The bank on being satisfied with these allocation of drawings and programme of dispatch, used to allow payment of the allotted sum in each month against requisition from the owner of the tea estates. Periodical reports from the garden manager had to be obtained for examination as to how the money was being spent and how the garden was being worked.

The bank made its position on the sale of tea quite clear—

> So long as the Government of United Kingdom continued their policy of bulk purchase of tea from India and Pakistan, tea gardens under the finance of the bank must be insisted on entering into contract with the government of UK. This will ensure the sale of tea at a reasonable known rate free from market fluctuations. In such a case, it is to be observed if the contract is fulfilled by the T.E. concerned, by tendering the produced tea to the UK representative. If any tea is rejected, the reason shall be ascertained and the bank has to be satisfied about the steps taken by the tea estate authorities in amending the defects for which the tea is rejected (Annual Directors' Report, UBI).

In the early 1950s, the economic conditions of India and Pakistan were not good and the bank found some loans in these places to be irrecoverable after all possible attempts and had to write them off on the recommendation of the Executive Committee of the Board. At that time, periodic reports were submitted by the Controller of Accounts regarding realization made in hard and irregular accounts.

The progressiveness of the bank's financial practice is evident from the fact that the bank participated in Corporate Governance by virtue of holding equity shares in some cases. B. K. Dutt was authorized to represent the bank and cast vote in the Extraordinary General Meeting of the shareholders of Assam Financial Corporation, a client of the bank.

The Financial Press

As before, the financial press played an important part in the positive and normative evaluation of the growth process to which banks like the UBI subjected themselves. The press realized that the institution of private banking enterprise was subject to enormous potential risks with respect to credit default, interest rate changes, liquidity shortages, security enforcement problems, failure of strategy and implementation and operational problems. The industry was a young one and had already been subjected to at least two pronounced rounds of banking crises in the pre-Independence period and it had to be nurtured and monitored with extreme care.

We have already noted that for some banks, profits were fairly high, not only by national industry standards but also by international ones. A few like the UBI, however, showed low profits with respect to deposits and operational costs. However, some labour leaders and financial analysts challenged the reports shown in the balance sheets. They argued that these banks were in fact earning healthy profits but not fully disclosing the profits, channelling the undisclosed parts to the undisclosed reserves so that they would not be pressurized to revise wages and dividends with profits. Thus ran an article in *Capital* in the mid-1960s (1966: 98),

> Both shareholders and employees are eagerly waiting for the working results of banks for 1965, although they know that the disclosed profits do not necessarily provide a correct indication of the real level of bank profitability. At the best of times, it may be presumed, the management of banks make large undisclosed provisions—not only for bad and doubtful debts and for the depreciation in investments, but also for the uncertain future and for unforeseeable demands on bank reserves, which may not be so rare in banking as is commonly believed. The very rationale behind the banker's ability to revise their profits before disclosure is that some of the fruits of prosperity should be stored away in secret reserves as an equaliser for the bad times that may alternate with the good. Similarly, in the worst of years, bank profits should not appear so bad as to create panic among depositors and shareholders; the undisclosed reserves should be drawn upon in such circumstances.… The computation of bank profits is a top secret and a highly complicated matter at all times, because of the existence of what is described by the bankers as their closely guarded 'contingency ledger', to which very few people have access.… It has become more of a mystery on

> account of the statutory provisions and a difficult formula for differential payments of bonus to various categories of employees.... Both in the United States and the UK, there is an increasing body of opinion against the present practice of allowing banks to make undisclosed appropriations. Here in India, the question has not been discussed in public so far. The time to consider it with all its implications may soon come.

The financial press also reported concentration of wealth and power in the hands of a few families and in the field of banking it noted the inadequate branch expansion in rural areas, interlocking of directorships between industry and banking, the rise in accumulated bank profits and the growing monopoly power of the banking industry. All these were evoking negative responses from the socialist politicians and parties and from a section of the general public as well. The demand for social control or nationalization of the banking system was thus increasing. However, the financial press took a clear position against such a move. It argued that nationalizing the banking industry would further worsen the labour situation which was already bad since banks were burdened with unreasonable Banking Tribunal awards on wages and working conditions, which did not give any incentive to labour productivity. Nationalization under such a situation would entail taking over the labour problem in banking. Also, the productivity and profitability record in the public sector was not healthy so as to encourage the thought of bringing banking under its purview. The issue of social control was carefully analyzed by the financial press—on the one hand, there was the unquestionable need for financing of agriculture and small-scale business, on the other hand, it was an open question as to how constraining the banking system in order to restructure itself to finance these sectors was going to be more productive than financing them through specialized financing agencies. On the issue of interlocking directorship, the financial press took the side of the bank directors who thought such an arrangement was conducive to free exchange of information and expertise between banking and industry. As indicated earlier, the financial press conceded that undisclosed reserves were a controversial issue, which needed public debate and an efficient resolution through policy. But the press did not see anything wrong behind supernormal profits of banks since the business of banks were to generate profits and such profits could be used as a significant cushion, not only against uncertainty in banking but also against aggregate economic fluctuations. Further, the following was noted that with respective to the allegation of monopolistic practices:

> Monopolies Commission, which went into the question of concentration of economic power, was unable to find any evidence of the existence of monopolies in banks, concentration in advances or abuse of power and misuse of funds. Moreover, Reserve Bank has almost complete control over the banking system and the money market. Therefore, state control is unnecessary (*Capital* 1966).

For the stability of the banking industry, the financial press favoured a structure where the concept of banking was clearly enunciated and the number of banks brought down, where each would have sufficient capital and liquidity to face risks. It happily noted that through the efforts of the Reserve Bank, in keeping the definition of a bank simple (depository institution which makes investments and provides credit with no special provision for the term 'principal business') and through the practice of licensing, the number of scheduled banks had fallen drastically in the first half of the 1960s. This was shown to have happened in several ways—some hitherto banks were gradually declassified as non-banking companies since they were engaged in other activities apart from banking, many banks were forcibly merged to save them from liquidation, and there were also a few voluntary mergers and some takeovers of small banks by their larger counterparts.

The press was particularly sympathetic about the problems that banks faced through high deposit rates and establishment costs. Though deposit rates were somewhat kept in check through the intervention of the Indian Banks Association, the issue of high establishment costs was something that each bank had to deal with individually and those banks, having invested in large establishments in their initial years, were heard with concern. A particularly memorable one was the reported speech of the UBI chairman in 1967—

> During the year 1966, the 5,500 workers of our bank received Rs 3.43 crore as their income, against Rs 20 lakh paid as dividend. It is therefore, high time that workers in this country realized their own interest and limited their demands within the bounds of rise in productivity and refused to be guided by illusory concept of conflict of interest (*Capital* 1967).

Notes

1. These plans were submitted to the Rural Banking Enquiry Committee in 1952 and National Credit Council in 1967. Dutt was a prominent member of these august bodies.
2. Interview by the authors.
3. The bank spent considerable resources on advertisements that would induce people to develop better savings habits. Data attests to the fact that such campaigns were by and large successful.
4. From the Manual of Instructions 1950–1969.
5. From the Minutes of Board Meeting.

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4

NATIONALIZATION AND THE ORGANIZATIONAL CHALLENGE

In 1969, the government nationalized 14 scheduled commercial banks and introduced the concept of development banking, which was going to be the primary aim of the nationalized commercial banks. The response from certain quarters of the public and media was positive; there was a general air of high expectations with regard to the growth in agricultural credit and credit to the small-scale sector that the economy so badly needed. There were also negative opinions amongst some of the political parties and the general public with regard to the possibility of a fall in the quality of banking services, the erosion of profitability and capital, and a lack of commercial orientation that nationalization entailed. To realize the positive expectation and counter the negative one, the challenge posed to the banks was formidable. They had little experience in agriculture and small-scale industry finance and they had to equip themselves with an appropriate strategy and organization structure to meet such needs and the responsibilities of lead banking. In this chapter, we examine the nature of the challenge posed at the level of the individual bank, that is, the United Bank of India (UBI), the dimensionality of the problem, and the response of the bank in strategic and organizational design aspects. One can clearly see a direct mapping from each dimension of the problem of development banking to the response in organizational restructuring and design of operational procedures. Accordingly, the activities of planning, operations, personnel, credit, recovery and vigilance were going to be transformed and the organization was going to be decentralized. Detailed planning and management oversight was required in crafting the strategy and structure, and UBI was one of the banks which rose to such a formidable challenge eminently. However, there was the big problem of marrying the social responsibilities and commercial orientation in banking, which would affect the planning and performance of virtually all the nationalized banks. The UBI was not an exception, though it strove hard to fulfil different kinds of disparate objectives.

The Background

Since the beginning of the planning process, a pattern in commercial banks' policy and orientation was becoming obvious—they favoured large industry and established business houses. This was facilitated, in the words of D. N. Ghosh (the former Chairman of State Bank of India), 'by the policy of the authorities to preserve stability of the system rather than regulate the direction of its growth' (1979: 215). Perhaps more important was the fact that distribution of credit had become a matter of concern for many by the early 1960s. The change started with a conscious effort to induce a greater flow of credit to the small industry. Simultaneously, the Reserve Bank was empowered at this time to intervene in the management of the commercial banks. The agricultural sector which had been voicing its concern over the constraints of the agricultural cooperative credit agencies in meeting the requirements of credit (especially for financing of the high yielding varieties programme) was asking for a radical change in the credit allocation pattern of the banking system. This demand could not be ignored anymore when, in the wake of the two successive droughts of 1966 and 1967, the need for assuring a steady flow of material and financing inputs for agriculture became an overriding national objective.

> This gave an excellent opportunity for the new agricultural class in the countryside, which had started reaping the benefits of industrialized agriculture, with the high yielding varieties programme actively sponsored and supported by the State, to attempt to appropriate whatever share of credit they could have from the resources of the commercial banking system and make the commercial banking system shed its close preserve character (Ghosh 1979: 222).

In May 1967, Rajya Sabha debated (on a non-official resolution) the question of nationalization of the scheduled commercial banks.

The government had to accept, for the first time, the possible beneficial effects of such a proposed measure and promised to look into the working of the commercial banking system with special reference to credit allocation. In December 1967, the Policy of Social Control of the banking system was announced in Parliament. The basic objective of the policy was 'to ensure, in the immediate future, an equitable and purposeful distribution of credit, within the resources available, keeping in view the relative priorities of developmental needs' (Ministry of Finance 1967).

A National Credit Council at the all-India level was set up as the primary instrument of implementing the policy. Its tasks were set as 'assessment of the demand for bank credit from various sectors of the economy' and determining priorities for grant of loans and advances for investment, with regard to the availability of resources and requirements of the priority sectors, in particular agriculture, small-scale industry and exports. It is notable that the policy statement pertaining to social control mentioned it as a short-term measure. The basic problem was identified as slow deposit growth due to inadequate level of savings. It was pointed out that the credit rationing problem for some of the sectors like agriculture, small-scale industry, exports, and so on, would cease to exist once resources were mobilized in adequate quantity by the banking system. However, to such sectors, the manifestation of the problem was perceived as an outcome of power equations in finance. To them, it was imperative to reduce the influence of large industry and powerful business houses on the banking system. Following their demands, the Council had to deliberate over the policy of constitution of the board of directors of banks and suggest legislative measures which constrained (though not totally eliminating) industry leaders from sitting on the board of banks. In the three meetings that the Council had over its lifetime, there was general agreement that the main issues were of deposit mobilization and credit allocation to the different sectors of which agriculture and small-scale industry, became particularly important. During the second meeting of the Council, the targets of Rs 35–40 crore and Rs 60–70 crore were fixed for agriculture and small-scale industry, respectively. The commercial banks, it should be noted, had no difficulty in attaining the targets. In agriculture finance, the main purpose was infrastructure development, which, in terms of long term needs, meant rural electrification, lift irrigation, mechanization, storage development and, in terms of short term financing, use of fertilizers (which received a major boost in funding), and improved seeds and practices. It should be noted that increased outlay to agriculture was welcomed by an important segment of the industry—the industrial concerns who could provide the storage, transport and marketing facilities, and the agriculture oriented chemicals and engineering firms. They had survived the recessions of the mid-1960s thanks to the resiliency of agriculture and now they became poised for profitable growth. Soon it became clear to the industrial groups still controlling a large part of the banking system that credit for the priority sector ultimately resulted in higher demand for industrial products, directly and indirectly. Therefore, it was felt that it would be better to institutionalize the emerging demand for credit by this sector within the existing framework. The opposition to socialization of banking began to weaken with the gradual realization of this positive structural relation between agriculture and industry. Given the tremendous influence of the agriculture sector in the democratic set up of the country, the time became ripe for a bolder and more permanent measure— the nationalization of banking.

> The decision of July 1969 was a complete break from the tradition of indirectly controlling the banking system through regulations and monetary policy. It was an explicit recognition by the government that it could not absolve itself of its responsibilities of controlling directly the banking system if it was to be reshaped as an instrument of further economic development, in accordance with national objectives and priorities (Ghosh 1979: 227).

In her broadcast address of 19 July 1969, the day banks were nationalized, Prime Minister Indira Gandhi explained that nationalization was intended to 'accelerate the achievement' (Ghosh 1979: 227) of the objectives of social control, which were elaborated as—'(*a*) removal of control by a few, (*b*) provisions of adequate credit for agriculture and small industry and exports, (*c*) giving a professional bent to management, (*d*) encouragement of a new class of professional entrepreneurs and (*e*) the provisions of adequate trading as well as terms of service of the bank staff.'

The explanatory statement on nationalization made in Parliament on 21 July 1969 emphasized that the objectives of the nationalized banks would be to actively foster the growth of new and progressive entrepreneurs and to create fresh opportunities for hitherto neglected and backward areas in different parts of the country. The main aims comprised the fulfilment of two main objectives, namely, mobilization of deposits through a massive programme of branch expansion, especially in the non-banked rural areas, and diversification of bank credit to ensure a flow of financial assistance to the neglected sectors of the economy in growing measure.

The Thoughts of UBI Leaders on Socialization of Banking

In B. K. Dutt's critique of the framework of amalgamation and of large, urban banks, we do see a recognition and, in fact, a call for, a greater controlling and even investing role of the state. Part of this was naturally the acknowledgement of the Indian economy as a planned economy. But a large part of this recognition of the state's role came out of his and probably others' assessment of the inequitable nature of the post-colonial Indian economy and the inadequacies of the banking sector as it existed then. To an extent, this was also an acknowledgement of the socialist vision of the intelligentsia of the 1950s and the 1960s, which showed that India must embark upon a path of greater equality under state supervision if existing institutions, with their long colonial histories, were to be saved from socio-economic and political subversion (Dutt 1956: 38).

Already in the 1950s, it was clear to B. K. Dutt, N. N. Law and others in the top management of UBI that banks should not function as large, urban monopolies, which restrained competition and engaged in unrestrained profit maximization irrespective of the social consequences. In the previous chapter, we have seen Dutt's arguments against large, monolithic banks; N. N. Law, on his part, insisted repeatedly that banks should not compete with each other at the cost of the developmental orientation of the institution.

In 1967, Dutt had already proposed an 'Outline of a Scheme to Ensure Socialization of Banks',[1] which could result in a localization of the functioning of banks to ensure regional development and the meeting of the requirements of the small man, both in industry and in agriculture.

> The objectives of national economic growth have been defined to include balanced regional development, optimum utilization of local resources, wide employment opportunities and reduction of inequality in income and wealth. Questions have rightly arisen whether the present banking system is designed to serve the needs of those objectives. But any corrective action based on the assumption that the inadequacy of the banking system, in this regard, arises from the bankers' prejudice against, or aversion to, the activities involved in encouraging utilization of sectoral resources, would not only be misleading but frustrating. A realistic appraisal of the position would show that the prevailing inadequacy is a coefficient of the structural shape of the system dominated by a panoramic view of things and events.[2]

Dutt's plan was simple. The fundamental need, he pointed out, is that each bank's future should directly be tied up with the economic development of the zone in which it will operate. It would then be under a structural pressure to leave no stone unturned to develop the zone of its operation, insofar as imagination and appropriate objectivity, along with the provision of finance, can achieve such development. It was therefore necessary to bring about a system which would confine the area of operation of a bank to a designated banking zone.

The objectives of a scheme for a structural change were laid down as follows:

(*a*) Localization of functioning of banks to ensure, through proper motivation, intensive and expeditious regional development, including meeting the requirements of the small man both in industry and agriculture.
(*b*) To provide every local potentiality, comprising talent and material, with full financial support.
(*c*) To end easy recourse to large borrowing.
(*d*) To obtain an intensive coverage and better deposit growth.
(*e*) To ensure better performance of banking services in every area through competition.
(*f*) To ensure socialization without headache of ownership and through a better and closer participation in banking by the people and a better and close participation by banks in people's economic activities.

This was Dutt's mission and vision statement in a nutshell. There is something of Gandhian ideas of development being reflected here and also has a relation with the community participation literature developing in economics and sociology in light of recent experience of less developed countries (LDCs). From the modern viewpoint of information economics, one can say that usage of local resources where information is better available creates efficiency gains but there may be limits to it. His ideas on community participation in banking and group lending schemes, and emphasis on small borrowers are based on equity considerations, rather than efficiency gains from activities such as peer monitoring, which is the argument in favour of micro-credit institutions nowadays. What is missing is the appreciation of the free rider problem that arises in the sphere of cooperative arrangements. Perhaps one cannot blame Dutt on this issue since those were the days of valour and self-sacrifice. Sadly, things have changed and some of the ideas can only be called unrealistic ideals in today's maximizing and opportunistic society. Another issue that Dutt overlooked was the possibility of frequent and large financial crises in a system dominated by numerous small banks. As the American banking history testifies, a small bank would not be able to diversify its portfolio adequately and will become prone to liquidating bank runs caused by changes in fundamentals or panics. Clearly, the small bank model was not an ideal growth route as far as the stability issue was concerned.

In his ideas, therefore, Dutt seemed to be anticipating for a while the processes of which nationalization was the final result. His immediate reaction to the fact of nationalization was thus of one expecting a smooth transition. As he told the members of the Federation of Indian Chambers of Commerce and Industry (FICCI), a change in ownership really made no difference, either in what the business community might expect from banks or in the need for the Reserve Bank of India's monetary discipline and control measures.[3] In fact, Dutt was all for nationalization of banks 'in the sense of banks operating under an overall direction of the government for using the resources for the good of the common man to increase production' (1994: 124). Dutt did not anticipate any problem with profitability, but expected that the servicing of the large credit needs of the agriculture and small-scale sector would generate new profitable opportunities. Dutt welcomed nationalization on the grounds that infrastructure would improve and modern technology would be introduced in banking and that nationalization would provide the workers with motivation by giving them a sense of the ownership of the banks. He expected considerable rise in employment together with business opportunities and self-employment opportunities for small families getting access to ample bank credit.

> Even in the field of agriculture, in particular, I thought that banks, with the superior technical personnel with them, would be able to help the agriculturists not only with necessary guidance and financial help, but also with assistance in setting up small ancillary or side businesses such as poultry farming, cattle breeding, pisciculture and fisheries, as well as small manufacturing units in handloom weaving, brick making etc. (1994: 125).

Though all the expectations were not satisfied even in the long run,[4] nationalization was initially welcomed by professional bankers like Dutt with a deep faith and they were ready to face the challenges and tasks awaiting them.

UBI and the Lead Bank Scheme

The fundamental shift in approach, in the post nationalization phase, inherent in the objectives and priorities outlined, was to make the banking system function as an instrument of development. This was the underlying concept of the lead bank scheme formulated in December 1969.

The National Credit Council appointed a study group called the Gadgil group, in October 1968, to study the organizational framework for the implementation of the social objectives by the banking system. In devising an ideal banking and credit structure for local development, the group was of the view that because of the diversity of conditions all over the country, an area approach was essential for appropriate credit and financing arrangements on the basis of local conditions. The group noted that historically over the decades, the cooperative system has had an in-built adaptability with appropriate tiers at the different levels, that is, the state, the district and the primary levels. However, the cooperative system did not deliver what it promised and the Gadgil group identified commercial banks as the substitute pace setters of local development.

> The area approach would enable commercial banks to identify and study local problems and evolve an integrated credit plan for supply of inputs and the processing, storage and marketing facilities and other services which may be locally needed and providing for participation, as may be necessary and feasible in the local conditions by the Reserve Bank of India, the state government, other commercial banks, cooperative banks and national financing and other developmental agencies. With nationalization, the difficulties of making the cooperative and nationalized commercial banks function in one system would be greatly minimized and the resources of the nationalized banks, commercial banks and the local knowledge of the cooperative agencies would be rationally combined (1968: 61).

The lead bank scheme, proposed by the Gadgil group, was endorsed by a committee of bankers called the Nariman Committee in August 1969. The committee sought to make allotments based on districts among major commercial banks in the light of their resource base, manpower availability and area of operation. As the scheme visualized, the designated bank for each district was made responsible for taking a lead role in surveying the credit needs, and problems and opportunities in the respective districts, and for identifying and financing suitable projects.

The UBI joined the lead bank scheme with a significant degree of enthusiasm and faith. During the first year, the work of collecting data from various sources in connection with the survey of the lead districts was completed. Two survey reports on the union territories of Manipur and Tripura were published. In the early part of 1971, two further reports on Midnapore (West Bengal) and Cachar (Assam) were also published. At a joint meeting of the public sector banks, under the auspices of the RBI held towards the end of the year, centres were identified and allotted to various banks for opening the branches.

In order to organize better the efforts and to provide adequate leadership to branches in the lead districts, the organizational structure was strengthened with the appointment of district development officers. Depending on the size of a district and the network of the branches of UBI, a senior officer was placed in charge of one or more districts and designated as the district development officer. Besides liaison with government and various other agencies, the task of this officer was to ensure intensive development of the branches under his charge with regard to deposit mobilization and extending credit assistance to various neglected sectors.

The UBI was assigned the role of a lead bank under the lead bank scheme of the RBI with respect to 15 districts—Bankura, Malda, Midnapore, Murshidabad, Nadia, Purulia, West Dinajpur and 24 Parganas in West Bengal; Cachar, Shibsagar, Nowgong, Dibrugarh and Lakhimpur in Assam; and districts in Manipur and Tripura. Detailed economic studies in order to identify prospective centres for location of branches and potentialities of deposit mobilization and credit assistance were completed. District level coordination committees were also formed with UBI as convenor so as to coordinate the efforts of commercial banks in the economic development of UBI lead districts in close collaboration with other financial institutions and development departments of the governments. For educating the rural people on the need to save and on the procedure of obtaining and effectively using bank credit, UBI launched a number of intensive publicity campaigns specifically designed for the purpose. The feedback on the results suggests that these measures vastly aided the spread of banking habits among the poor in these areas.

From the beginning, the bank management realized the need for a decentralized organizational structure and the need for suitable officers in charge of different districts.

> Appointment of the district development officer is part of our plan to reorganize the administrative structure of the bank. With a view to achieving a greater degree of decentralization of decision making power and making the administration more sensitive to the local needs and urges, a proposal to establish regional offices in charge of a senior executive and equipped with adequate staff has been approved in principle and as a first step towards its implementation, a regional office for Assam, Manipur and Tripura area is being established (Annual Report of the Director 1970).

After the district development and financing plans were formulated on an initial basis by the bank management, there was need for a dialogue between the various agencies involved in the development process. The banks, cooperatives, state government and other agencies had to coordinate their joint efforts in order to realize the goals of the development plans. The bank's experience in the coordination process was positive in most of the cases.

> In order to achieve coordinated development of banking in our lead districts, it is necessary to achieve a high degree of cooperation from other banks,

> financial institutions like state finance corporation, cooperatives and the government and other agencies of the districts. The Gadgil committee which first mooted the concept of lead bank, also envisaged such close cooperation and coordination among the financial institutions. In order to implement this idea and as an experimental measure, a coordination committee of financial institutions has been organized in Midnapore which is one of our lead districts. We are happy to report that all the public sector and other banks and the state finance corporation operating in the district and the district administration are fully cooperating with us in the work of the committee (Annual Report of the Director 1970)

The lead district scheme was vigorously pursued by the bank from the very beginning—during 1971, 40 branches were opened in the lead districts of UBI in the states of West Bengal, Assam, Manipur and Tripura, while only 14 were opened outside lead districts. At the end of 1971, the number of branches in the 15 lead districts stood at 149, which accounted for as much as 46 per cent of the total number of branches.

The year 1976 was a year of expansion and UBI's branch expansion and coordination activities in the lead districts continued with greater thrust and vigour during 1976. The majority of the branches were located in the eastern and north-eastern states. The lead districts allotted to the bank also belonged to these regions. The bank took appropriate steps, as part of its endeavour to fulfil the lead bank obligations and to reduce the imbalances in the banking developments in the lead districts. In 1976, these districts accounted for 61 per cent (108) of the branches opened by UBI. Of the 500 branches opened from the date of nationalization to 1976, 57 per cent (286) were located in these districts. As a result, the share of lead districts in the total number of branches increased from 26 per cent at the time of nationalization to 48 per cent at the end of 1976.

During 1976, the bank took a number of steps in its lead districts to promote integrated development of banking. In accordance with the recommendations and guidelines issued by the RBI study groups on the working of the lead bank scheme in Gujarat and Maharashtra, and the high power committee on the scheme, as also the recommendations made in the 62nd report of the Estimates Committee of the Lok Sabha, the bank streamlined the composition and geared up the activities of the district level coordination committees in the lead districts. Steps were taken to ensure effective coordination among the different development agencies, both financial and non-financial, and government and non-government.

The Challenge of Reorganization

Nationalization placed a tremendous burden on the bank—the bank had to mobilize savings and provide advances for the priority sector at unprecedented growth rates while remaining commercially viable. The organizational design, human resource and financial requirements were considered too heavy and were demanding not only a phenomenal increase in scale of almost each activity, but also a sea change in the scope and the nature of activities performed.

Establishing a widespread network of branches in backward and interior areas in the countryside within a short period required tremendous organizational efforts for identifying suitable areas and premises, selection and deployment of personnel, and planned and systematic supervision and control. Deposits had to be mobilized at a fast rate but with due regard given to costs. One of the costs was the marketing and advertisement expenditure; obviously, it had to be economized. Spending too little on marketing and advertising could result in inadequate deposit growth, while spending too much could lead to cost overrun in budgets, thus requiring cutting down on other important items of expenditure. The socio-economic parameters of the advertising and marketing strategy had to be properly planned at each branch level so that it would generate response from the local people. There was an important element of transaction cost involved so that the cognitive abilities of the branch manager and his superior officer would be tried—only through a rational process of trial and error could the right strategy be arrived at, and communicating such a strategy and convincing the Head Office for funds to defray such expenditure was quite another matter. Another item of cost was the cost of providing liquidity services. Depositors had to be paid attractive deposit rates and services while the risk of illiquidity in the portfolio of the branch had to be assessed all the time and managed through a judicious alteration in the level of liquid assets and reserves every now and then. Transaction costs associated with liquidity risk management were of two types—one was the cost of learning true liquidity risk of a portfolio in an efficient and expeditious manner; the other was the cost of providing incentives to the branch manager to economize on the cost of the provision of liquidity services. Together with interest cost, the total amount could be quite significant. Moreover, both types of costs could be quite high in branches in remote and economically underdeveloped areas where the marketing cost per capita was going to be high, the nature of liquidity risk was by and large unknown, and the branch operation was subject to sudden and correlated withdrawal patterns. From the viewpoint of the Head Office or the regional office, the wide variety of circumstances under which different branches would have to perform was another daunting task. Coordinating between different branch offices, maintaining information and monitoring were some of the unenviable tasks that the regional office would have to bear.

The financial resources requirement for fuelling the growth of priority sector lending had to be met through intensive and extensive branching and marketing of financial services. Financial services like letters of credit, overdrafts, mortgaged lending, loans for buying agricultural inputs and for marketing produce, lending to small business for buying equipments, and so on, had to be tailored to meet the socio-economic objectives of the planning process. At the same time, these financial products and services had to handled with the prudence required from a commercial bank. Success depended upon the extent to which the branch managers, regional officers and district development officers could be made to stretch themselves in understanding the conditions of agriculture and small-scale business, which involved both cognitive and motivation costs. Agriculture and small business were the two pillars of the priority sector credit planning and operations. Coping with the agricultural requirements and vagaries in different regions with different soil types, rainfall, water access and institutional practices of farming were some of the tasks the bank was ill prepared for. Small business posed an even more dangerous challenge—being too widely spread in terms of one's monitoring ability. It was recognized at the outset that a significant proportion of loans, especially those in the priority sectors, would be prone to voluntary and involuntary default requiring a special emphasis on recovery.

One of the foremost priority areas was that of human resource mobilization and development; it involved the recruitment and training of staff, deploying them effectively and providing them with the necessary guidance, incentives and motivation for satisfactory completion of the tasks to which they were assigned. Expertise building in lending to different groups of borrowers was also part of the challenge of human resource development, but the real challenge was to transfer the employee expertise to the permanent knowledge base of the bank.

Operational procedures had to be evolved to cope with the complexity of tasks that nationalization involved. Routine processes which had worked well for a small number of branches prior to nationalization were not necessarily suited for the post-nationalization period. Credit was controlled primarily from the Head Office in the pre-nationalization period, while the credit for the priority sector demanded that it be decentralized at the branch level in the semi-urban and rural areas. Yet, the operation of credit provision was too important a task to be left to the discretionary powers of the branch managers. As a result, credit guidelines and norms had to be prepared for the branches. Different types of security and covenants had to be designed for the different agricultural activities and the different small-scale activities. At the same time, in order to manage liquidity risks smoothly, guidelines and norms had to be evolved for depositor accounts too. In other words, the branch in the post-nationalization era had to face the challenges imposed by a high growth rate and a high degree of uncertainty that had to be faced through a myriad of financial innovations at the organizational level, that could streamline procedures and bring in a high degree of discipline and order, keeping the discretionary power of a branch to a small residual. Inspection and vigilance procedures at the branches were recognized as extremely important, especially as the organization was anticipated to grow significantly in size and scale and, therefore, detailed norms and protocol had to be evolved in anticipation of such growth.

But designing operational procedures for the lower level offices like regional offices and branches was only part of the challenge of the organizational design. Balance had to be struck in the organization design between centralization and decentralization, between rules and discretion, and between incentives and risk sharing. An overly centralized organization could involve costly delay in the execution of decisions at the local level; on the other hand, a highly decentralized structure could make the task of proper coordination between the various activities difficult. The lead banking responsibilities meant that a sufficient degree of decentralization characterized the organization structure anyway. The top management had to choose from a menu of alternatives and they chose gradually accelerating decentralization, which is discussed in the next section. However, to solve the coordination problem, a certain degree of centralization was needed; a multidivisional organizational structure would be devised whereby a set of activities requiring common administrative coordination would be housed under a particular division. The problem of rules versus discretion in administration was an extremely delicate one. Excessive rule orientation could kill the spirit of entrepreneurship required from junior officials like branch managers, while too much discretion could make the job of planning and coordination at the higher level difficult. The choice was going to be one selected on the basis of past experience and future projections of the different aspects of branch operations. Then, there was the issue of motivating employees through incentives built in promotions and performance related salary structures. Branch managers and other employees had to be given performance incentives through bonuses, promotional prospects, and so on, but to the extent that these incentives were too sensitive to performance they would not work, since the risk averse employees would require a reasonably flat salary structure with respect to performance. Also, the bank being a Central Government organization, the scope for innovation in pay scales was limited. Again, a balance had to be struck and at the beginning of nationalized banking, it was not clear what the appropriate trade-off between risk sharing and incentives was. Consideration of these factors would determine the nature of the hierarchy in the bank, the delegation of portfolio management, degree of communication, nature of contracts and rules, and the residual decision-making authority for each type of transaction.

But perhaps the most important factor was going to be the development and execution of the corporate business plan which would coordinate every aspect of banking through a team of managers. With development banking and the lead banking scheme, the plan became a socio-economic development-cum-banking plan. The development of the plan would depend on the targets set by the finance ministry, the organizational capabilities required by such targets and the developmental needs and business potential at the branch level. A too ambitious target would imply that the bank stretches its resources and tries to mobilize maximum business (at a very high cost) at the branches. It would further imply a restructuring of the organization such that maximum effect could be obtained at the branch levels with minimum loss of central control. Given that the targets set were really ambitious for almost every (nationalized) bank, the banks were challenged to find an organization structure capable of satisfying these conditions. The execution required a hierarchical mode of communication of information, information processing and decision-making. Both the development and the execution of the plan required a hierarchical structure, where an intermediate level of authority[5] could be established between the Head Office and the branches for the sake of speed, reliability and autonomy in decision-making and information transmission. The management of such a multi-layered organization was going to be the ultimate challenge.

The successful management of the bank required an efficient strategy of growth, which in turn would require an optimal organizational structure for implementation. This link, between strategy and structure of the organization, was felt by the top management in the same way as it was felt by some of the major players in the manufacturing industry in USA, as described by Chandler (1962). The organizational structure, in turn, had to be made functional through efficient business processes and decision-making rights. This too was clearly recognized by the top management. However, the multiplicity of objectives involved in development banking prevented the strategy devised, organization restructured and processes engineered from having the maximum overall impact, and it would be commercial orientation that would suffer, despite many organizational safeguards being put in place.

The Process of Organizational Growth and Decentralization

As the bank grew in terms of business, there arose a number of challenges for the organization. A principal one was the problem of monitoring of branches. With phenomenal rise in the number of branches each year, the Head Office was put under increasing stress in terms of monitoring, evaluating and providing directions to the branches. As a result, the system of zonal and regional offices was resorted to, which would carry out these activities for the branches under their jurisdictions. The Head Office continued to be involved in terms of monitoring the regional offices, but the exercise of control became indirect rather than direct. Another issue was with respect to the growing complexity of the job requirements under nationalization. Head Office administration required increasing degree of specialization among the officers. The lead bank activities required increasing number of officers dealing with district development and coordination with different agencies. The technical personnel at branches had to be increased to deal with different financing requirements of the five-year plans (like for example, the 20 Point Programme which required investment in organization and manpower to a considerable extent). Restructuring the Head Office organization to deal with growth and decentralization was another important challenge. The most important issue was the overall design of the administrative hierarchy in order to bring out—(*a*) efficient gathering and processing of information, (*b*) development plans that were able to meet the requirements of centrally allocated targets, while remaining sensitive to the needs and performance of the remote branches, (*c*) economy in the method of monitoring of branches, and (*d*) developing and allocating manpower according to growth requirements.

During 1971, the plan to reorganize and decentralize the Head Office administration was finalized. The decentralized administration consisted of three main functional areas, each headed by a senior executive. The branches were divided among five regions, each headed by a regional manager. Apart from the lead districts of the bank, a district development officer was appointed in all the districts where the bank had branches (there were 17 district development officers at the year-end).

In 1972, the Head Office departments were reorganized and importance was given to five principal functioning areas—accounts, credit, development, management services and personnel. The erstwhile methods and systems department, was reorganized into the management services division. This division had two wings—

organization and methods department, and management development department. In order to fill up the lacunae in information gathering and processing, statistical forecasting and detailed planning, a new department entitled, 'research and development department', was set up. This department had four sub-wings of research: branch development, farm finance and small business finance. B. K. Dutt had been insisting for a long time regarding the need for a technical cell and the cell finally came up in the year, with 30 technical personnel with knowledge and experience in various branches of engineering and technology. The cell was headed by three senior technical executives.

In 1974, the number of the bank's regional offices increased from five to six. In 1975, the number jumped to 10. At the end of 1976, the number had further gone up to 13. At the end of the year, the number of Deputy General Managers (DGMs) was raised from two to six. With the spread of industrial sickness, the credit sanctioning procedure tightened with considerable need for oversight and the credit recovery process became more complex as rehabilitation proceedings demanded a new set of skills. The supervision and follow-up of sick industrial units and their rehabilitation finance was assigned to one DGM. The other DGMs were put in charge of areas like administration, accounts, credit and inspection.

With the passage of time, it was felt necessary to increase manpower and financial administration at the regional offices so that they could cope with the branch expansion programme of the bank and to deal promptly and efficiently with the diverse requirements that arose in the management operations of the branches. It was felt that in order to control the expansion of the bank in different states, more regional offices had to be set up. During 1977, certain corrective steps were taken with regard to these requirements. A new post of assistant manager (advance control) was created for each regional office. Also during the year, one full-fledged regional office of the bank was established for the branches in the state of Orissa. As the profit situation was not one of significant growth after several years of nationalization, as industrial sickness spread and as priority sector borrowers tended to take the bank loans for granted, it was felt by the management that the focus of the credit recovery had to be intensified in the priority sector areas. Repayment cells were set up at the district development offices to intensify the drive for repayment of priority sector advances. Several other developments were worth noting with respect to 1977. One was that of a new deposit mobilization cell which was set up at the Head Office, keeping in tune with the faster deposit growth potential of the bank in the city. The other was that the business processes at the credit department of the Head Office were more formally recognized through restructuring the department into a policy, planning and monitoring division, a reconstruction and counseling department, and three sanctions and control divisions. A special cell was created at the Head Office to look after the reconstruction of hard and sticky loans in small business, and small industrial units under the finance of the bank.

In 1978, the functions of the DGMs were regrouped at the Head Office. Two DGMs were designated as DGM Coordination, all the regions were distributed between them and they were made responsible for all operational matters with respect to their regions. One of these DGMs was assigned additional responsibility to look after foreign exchange, and credit planning and policy. The portfolios between DGM, Personnel and Administration, and DGM, Inspection and Accounts, were rationalized through suitable reallocation of the different divisions under them. The reconstruction cell (small business finance) which was previously under the DGM, Planning and Development, was brought under DGM, Reconstruction and Counseling. A new division named Sanction and Control Division IV was created to pay special attention to priority sector advances and was placed under DGM, Planning and Development. During the year, attention was given to reallocation of regional jurisdictions and assignment of regional headquarters in tandem with the geographical spread of the branches of the bank. Also, the departmental functions of the regional offices were regrouped. The assistant regional managers who had previously been entrusted with specific functional responsibilities, were given greater authority and control over a specific group of branches.

In 1979, two posts of General Manager (GM) were created. The inspection, accounts and the engineering departments, and the departments under DGM, Planning and Development, were placed under the overall charge of one GM, while the credit department, coordination department and the departments under the DGM, Personnel and Administration, were placed under the overall charge of the other GM. At the same time, seven new posts of Assistant General Managers (AGMs) were created for better supervision of different Head Office departments and regional offices.

The year 1984 was important as the hierarchy of the administration of the bank was further decentralized by creating a new organizational tier between the Head Office and the regional offices—this was styled as Business Development and Performance Monitoring (BDPM) units at selected centres, each headed by a senior level officer (AGM, DGM or GM) for close monitoring of the working of the regional offices. Also, during the year, the bank opened eight more regional offices.

The Organization Structure, Design and Functioning

The organization chart of the Head Office is shown in Appendix 4.1. Barring minor alterations, this structure has persisted since the early days of nationalization. The secretariat of the Chairman and Managing Director (CMD) and the Executive Director (ED) was entrusted with the responsibility of attending to all work relating to meetings of the Board of Directors and meetings of the management committee of the board of directors, acting as a clearing house for all communications, acting as convenor of top management committee, keeping CMD or ED well informed about the state of affairs of the bank, coordinating departmental activities, and monitoring and supporting the functioning of the regional offices. The ED had two departments under him, each headed by a DGM—the merchant banking department and the international banking department (the specified activities of the two departments are given in Appendix 4.2). There were six wings which were to function under the CMD and the ED—the planning and development wing, the operations wing, the personnel wing, the credit wing, the inspection and vigilance wing, and the recovery wing. Each of them was headed by a General Manager. Each wing, in turn, would have its separate secretariat and divisions or departments.

The General Manager in charge of the planning and development wing had a DGM under him, who in turn would supervise the Assistant

General Manager (Planning) and the Assistant General Manager (Development). Under the Assistant General Manager (Planning) would be the regional rural bank division, the chief economist (economic research and library), the chief manager (statistics and long range planning), the chief manager (organization planning) and the chief manager (organization and methods division). The managers in charge of marketing, branch expansion, customer service, public relations, stationary and security would report to the Assistant General Manager (Development).[6] The division between planning and development was neat, and allowed the development of specialized skills and knowledge capital to grow. However, there was also an implicit hierarchy not reflected in the organization chart. The planning division had to set the ball rolling by developing plans and generating forecasts, which in turn had to be operationalized by the development division through branch expansion, marketing and other activities. In turn, the feedback from the latter activities would be incorporated in the next round of research and planning. The economic research department was set up to study the economic environment under which the bank was operating and to conduct research into various operational aspects of the functioning of the bank vis-à-vis that of the banking industry on a regular basis and provide inputs to various departments. Specifically the department was responsible for formulating a corporate plan based on corporate aspirations, and the directives issued by the government of India and RBI, and developing a business growth plan in accordance with the corporate plan, in light of the constraints and opportunities experienced in the process of growth of the bank, and the economic regions and communities it served. It is noteworthy that the corporate plan was essentially one of growth and not framed in terms of maximizing value, as measured by the discounted sum of cash flow adjusted net profits. Rather, the plan for improving profitability, efficiency and productivity was developed as a supplement to the corporate plan and was required to dovetail with it. It is quite clear that nationalization had an enormous impact on corporate culture in changing the orientation from value maximization to being an instrument in the socialization of the banking industry growth process. The strategy as perceived in the plans and goals of the bank reflected this and the organizational structure was redesigned to maximize the particular growth process envisaged. What would initially be seen as unimportant arithmetic in terms of loss of efficiency, profitability and productivity would over the course of time develop into colossal figures and create severe ruptures in the growth process. The fact that Indian banking could not efficiently marry the concept of social banking and that of commercial orientation, would become apparent only too late, as we shall see in the chapter where we revisit the recent banking crisis. It must be noted in this connection that such business plans were monitored, analyzed and reviewed with vigour by the department, and it left no stone unturned in order to improve the performance of the branches, regional offices, zonal offices and the Head Office. Unfortunately, the yardsticks of performance appraisal were not completely suitable for healthy commercial banking since they would be based on turnovers and volumes of transactions, with little weight on the net costs in generating such high turnover and volume, and with even less weight on the profit for each type of operations (several operations were yielding negative profits from the very beginning). The statistics and long range planning department worked in close cooperation with the economic research department in developing, monitoring, review and appraisal of the business plans. It was entrusted with the responsibility of participating in the credit budget exercises, identifying performing and non-performing branches, industries and regions, building up various forecasting models, extending statistical support to different departments, compiling and submitting data to different agencies, preparation of briefs for meetings of the executives with the RBI and finance ministry delegates, and extending assistance in preparation of the annual report of the bank.

The organization form, system and methods optimal with respect to changed circumstances were entrusted to the organization and methods division. However, the optimization exercises by such departments were subject to the constraints imposed by the corporate business growth plan, as mentioned before. As a result, despite the continuation of high costs and low profitability in several aspects of the bank's services, marginal change was observed in organizational structure, systems and methods. The organization planning department was put in charge of the review of the organizational set-up of the bank, in terms of additional divisions, cells, offices planned or bifurcation of the existing offices, delegation of administrative and financial powers to different functionaries, merger of loss making branches and decentralization of work of different departments. The costing division handled all matters related to evaluation of costing and profitability of all banking and non-banking services on a continuous basis, had the responsibility of suggesting norms or systems to improve the profitability and reduce the costs, and conducted studies inquiring into the economics of bank branches and different banking schemes. As mentioned earlier, while constraints were imposed on costing by the business growth plans, it was equally true that the costing division failed to come up with costing procedures especially with regard to keeping establishment costs in check at the branch and the Head Office level. The organization and methods division was put in charge of study and review of existing systems, procedures and methods in terms of forms, registers, books of accounts or statements and information systems, of preparing and updating manual of instructions, compendia of selected circulars, and so on, maintaining control numbers and copies of circulars and all matters relating to service charges. With too much emphasis on internal control during the process of high growth, these procedures and methods could become an obstacle to flexible and efficient banking. While in terms of outward appearance, the organizational structure was becoming more decentralized, in reality, central control did not diminish. This was not a function of the organization design but rather the management of the organization at the top level. Unfortunately, even with such rigid control, costs could not be curtailed and profitability would remain low during the first two decades of nationalization.

The branch expansion division of the planning and development wing was put in charge of the preparation and submission of branch expansion plans to RBI; submission of application for licence for opening of branches, extension counters or offices to RBI; and monitoring of implementation of branch expansion programme. The division was also entrusted with the responsibility of guidance and assistance to Head Office departments, regional offices or other controlling offices in the matter of business development and branch expansion. This division was to play a critical role in the process of growth and therefore was assigned substantial resources in terms of manpower and funds. The marketing division was put in charge of development of various products like different deposit schemes; keeping in view the demand of customers, review and monitoring of the existing deposit schemes; collection of information regarding exploitable business opportunities; assistance in formulation of the marketing strategy of the bank; and ensuring overall and region-wise deposit growth as per plans set by the bank through promotional, developmental and other measures. Customer service department was set up to carry out continuous evaluation of quality of customer service rendered at the branches through a structured questionnaire on items of service (as also through outside specialized agencies as and when necessary) to implement various Government of India directives and recommendations (example, the Goiporia Committee recommendations relating to improvements in customer service which also involved arranging for customer audit); to evolve strategies for achieving greater customer satisfaction; and to implement such strategies in liaison with the marketing department, operations and management department, and so on; and to implement 'ombudsman' (*Lok Pal*) as per government directive.

In the context of the changing pattern of the development of the national economy and in the sphere of banking in particular, systematic planning of business became an essential tool for the successful working of the banks. At UBI, such planning was hitherto being undertaken in a centralized manner. To cope more effectively with the changing situation, it was felt necessary to decentralize the planning and make it more comprehensive. As mentioned before, starting from 1971, the decentralization of the Head Office started. Branches were divided into five areas each, with a regional manager who had considerable responsibilities and oversight. Another step in this direction was taken for the first time in the year 1973 when the bank started the process of annual planning. Such plans related primarily to the following aspects of business—deposits, branch expansion, credit to industry, credit to priority sectors, investment, manpower, training and profits. For assessing the performance in relation to the plan, a mid-year review of the annual plan was also undertaken. On the basis of the experience gained in planning business for 1973, attempts were made at improving upon the plan formulation process for 1974. Appropriate guidelines in this regard were sent as an initial step, from the Head Office to the regional offices. Provisional regional plans were prepared on the basis of these guidelines as well as the past trends and immediate prospects of business growth at the branches in the respective regions. In the interest of systematic growth of business at the branch level, a system of performance budgeting was introduced during the year 1973. To start with, UBI's branches in Assam were covered under the system. For each quarter of 1974, the branches set budgeted levels of deposits, advances and profits on a provisional basis. After negotiations among the branches, the district development offices and the north-eastern regional office, the branch level budgets were finalized. In formulating the business plan for the bank, the performance budgets of the branches in Assam were taken account of. With effect from 1974, the bank adopted the performance budgeting system; in the beginning, the system covered the branches in Assam. For the year 1975, the branches in West Bengal and the north-eastern region were required to prepare performance budgets. By 1976, the network of the branches were covered under the system. Thus, an effective integration of the three tier (bank level, regional level and branch level) planning process was made possible.

In the 1970s, apart from such exercises in business planning, credit plans for initiating development of various economic activities in some of the backward areas were also formulated and implemented from select branches. A three-year credit plan for the development of irrigation facilities, custom service facilities, dairying, fishing and pisciculture was prepared for the Birohi Anchal of Nadia district. Similar plans were implemented in Ranaghat and other places. A credit plan for the lead district of Purulia was prepared in 1974. The plan presented estimates of sectoral credit needs of the district and indicated how the banks may participate in implementing the development programmes proposed to be undertaken in the district during the fifth five-year plan. From 1972 onwards, the bank was actively involved in sponsoring Regional Rural Banks (RRBs) in the backward areas and unbanked areas of the eastern and north-eastern states. The regional rural bank division was set up to monitor the performance and state of affairs of the RRBs including audit, finalization of accounts, financial and advisory assistance, training of officers, and so on.

For successful planning of business growth, research was undertaken continuously during the period to assess the performance of the branches in the different spheres. To help maintain close and continuous watch on the working of the branches, particularly those opened after nationalization, periodic studies were undertaken of current performance, future profit and loss, and business expansion implications of the branches. In order to guide the new rural branches, a model for the working of the branches with a view to achieving an early breakthrough was prepared and made available to the branches as well as used for discussion in the training programmes. Besides, business development plans were also prepared on the basis of surveys of the socio-economic conditions at select centres, where opening of branches were proposed in the immediate future.

While planning and operations were of critical importance, the success of these depended heavily on the skills and motivation of the personnel. Accordingly, a lot of importance was assigned to the organization and functioning of the personnel department. The personnel department was headed by a General Manager who had under him a DGM (apart from the Chief General Manager [Legal]). Chief Managers who reported to the DGM were placed in charge of each of the departments of statutory provident fund, human resource development, personnel administration (officer employees), pension, personnel administration (award staff), industrial relations and disciplinary. Most of the department names are self-explanatory, however, it is instructive to look into the task allocations for the three departments which were directly responsible for human resource development. The personnel administration (officer employees) department was put in charge of all matters relating to appointment, probation, promotion, retirement, service regulations, transfer or posting, leave, deputation and termination. The department was further put in charge of maintaining overall seniority list of all the officers of the bank and maintaining master personal files in respect of all the officers. The human resource development department was organized to prepare annual and prospective manpower requirement plan of the bank, maintain personnel records of all offices, select officers and award staff for training, oversee the functions of the bank's staff for training, review and strengthen training policy or methodology, prepare annual training plans, maintain performance appraisal reports of officers and make placement of requisition for recruitment of officers. The staff training college or centre was set up to function as the apex training institution of the bank and to provide guidance to the other colleges and centres in regard to their training activities. Administratively, however, the centres outside Calcutta were placed under the control of the respective zonal or chief regional managers, while the staff training college at Calcutta was made to report to the DGM (Personnel) at the Head Office. The staff training college was entrusted with the responsibilities of drawing up and conducting different training programmes for the various levels of the employees (sub-staff, clerks and officers),[7] evaluate the performance of trainees and send their performance reports to the concerned authorities, arrange for regular evaluation of effectiveness of the training programmes through feedback from participants and operating departments, and modify contents or methodology based on such feedback, provide guidance to other training colleges, take assistance from external faculty as per need and maintain liaison with other local as well as all-India training institutes (example, NIBM, NEIBM, BIRD, BTC, and so on). Also, training colleges of other financial institutions in keeping with the expansion of the branch network and the intensification of credit assistance to the various new sectors along with a faster increase in the staff strength became inevitable. During the year 1970, a total of 966 persons were recruited. The number of officers increased by 256, that of clerks and sub staff increased by 720 and 211, respectively. At the end of 1970, UBI had 6,922 persons on its staff; their composition being 1,009 officers, 4,012 clerks, cash clerks, typists, stenographers and others, and 1,901 subordinate staff. Such a fast rate of recruitment does not immediately fulfil the need for experienced people which was felt at the beginning of nationalization. In order to relieve the situation to a certain extent, particularly for placing staff in rural and semi-urban areas, retired members of the staff who had worked as agents, accountants or clerks, and who were physically fit to render services were given temporary appointments. Under this scheme, a total number of 36 persons were employed. The staff training college expanded its activities in keeping with the requirements of new branches and personnel. The college ran as many as 12 different courses for the staff and during the year, a system of evening sessions was introduced. During the year, the training college organized courses, for the first time, at certain centres outside Calcutta. Various courses were held at Guwahati, Patna, Durgapur, Delhi and Ahmedabad. This allowed the officers and staff to undertake training at centres close to where they are posted, instead of bringing them all to Calcutta. The college also continued to receive trainees from certain smaller banks during the year. This service to smaller banks was offered without charging any fees. Apart from courses run at the college, facilities offered by other institutions like the bankers' training college of the Reserve Bank of India, the Calcutta Management Association, the Small Industries Extension and Training Institute, the National Institute of Bank Management and others were also utilized to the maximum extent possible. Human resource development also occurred through investment in specialized knowledge and recruitment of industry experts. The UBI management felt that if, as a banking institution, it had been properly equipped with the knowledge of the conditions of these industries and had the necessary technical personnel, it could possibly have taken appropriate steps in time to stem the worsening conditions, at least in some of the industries. Thus, it was felt necessary to strengthen the staff with persons who have wide and deep knowledge in the respective industries, particularly where the bank had large commitments. With this purpose, a technical cell was built up in the early 1970s with persons drawn from different industries. The bank had in its rolls, as early as 1972, three senior technical executives, supported by nearly 30 technical personnel with knowledge and experience in different branches of engineering and technology. The purpose of the cell was to develop an intimate knowledge about the industries that the bank financed, to develop an information system about these industries and clients for control purpose, and to warn the management of the financed units about impending problems and make suitable change in the management, if such a need arose. Apart from the feasibility study of the technical and commercial aspects of new or expansion projects and technical guidance to the ongoing concerns, the technical cell undertook a diagnostic index study of the affairs of a number of problem ridden industrial borrower concerns. The studies revealed that these units suffered from various shortcomings and imbalances—such as management deficiencies, absence of production planning, lack of proper control on finance and inventory holdings, improper market study and/or absence of proper marketing organization for their products—which had contributed to the reverse of these units, posing a potential threat to the bank's interests. On the basis of findings of such studies, the bank took positive measures to revamp the management and marketing structure, and tighten the financial management and production control by making such industrial borrowers agree to appoint financial controllers, production managers or marketing executives, as the case may be. In several cases, nominees of the bank were also placed on the boards of these concerns as directors or observers to have a closer watch on the policies and performance of these units.

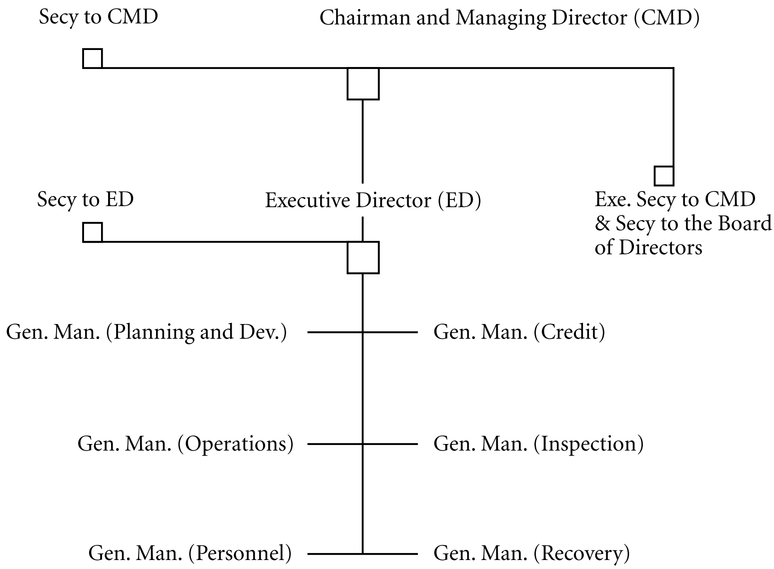
The credit wing was the primary focus of reorganization. The structure was partially decentralized as the branches, rather than the Head Office, had to disburse most of the priority sector credit. The Head Office was in charge of the overall credit plan, which it would communicate to regional offices and branches while continuously taking feedback from them. The rural credit policy, planning and operations department was structured to evolve strategies for development of agricultural advances of the bank, with a view to achieving various targets and sub-targets set out at the national and state level. In order to fulfil such an objective, the department was responsible for issuing policy guidelines to the branches, Head Office departments and controlling offices regarding rural lending, under schemes covered by the National Bank for Agriculture and Rural Development (NABARD) and initiate steps to increase advances under the Integrated Rural Development Programme (IRDP) as well as other self-employment programmes. Monitoring of rural lending and collection, maintenance and analysis of data relating to agricultural advances were some other important activities to ensure proper implementation of the credit policy. The lead bank division (formerly planning department) was entrusted with the responsibility of monitoring progress in the bank's lead districts, with respect to the formulation and implementation of district credit plans, mid-term revisions of annual plans as and when necessary, and functioning of the district-level and block-level forums constituted under the lead bank scheme and service area approach. The lead bank division was also expected to follow up the proceedings of the district consultative committee, district level review committee and standing committee meetings held in the lead districts and to guide and monitor the lead bank offices. Further, the division was entrusted to oversee implementation of service area approach with special reference to Service Area Monitoring Information System (SAMIS) and to monitor the process of data generation, transmission and maintenance, with respect to lead bank returns and other important parameters in all the districts so that district level policy could ably be guided by such an information system and data analysis. The small industries and small business department was set up to sanction and control advances to small-scale industries and small business sector advances falling within the purview of the Head Office, monitor and review performance with respect to small-scale and small business sectors (especially transport operators), report periodically to top management, and issue guidelines and circulars for the implementation of credit policy for these sectors. The department of credit policy, planning, monitoring and information was in charge of formulating the credit policy of the bank (including priority sector credit) as per directives received from the Ministry of Finance and the RBI. Such policy directives had to be interpreted by the department and then communicated to the branches and other offices through issuance of appropriate guidelines and circulars. The communication of credit policy to the regional offices, credit operations departments, to the relevant Head Office departments and to all the branch offices was thus entrusted to this department. Credit plan directives were translated into feasible credit targets which were allocated between states, districts and between the Head Office and branches, according to the actual and potential demand for credit, as estimated by the bank statisticians. The information set in the planning of credit policy included information on actual and potential borrowers, historical credit deployment pattern, projected credit demand across industries and districts, and exposure to different industries and groups of companies. Periodically, the credit plan would be examined in view of the returns and the growth exhibited by the portfolio and if a feasible allocation was estimated to give a better return and/or growth, then there would be a renegotiation of the credit plan. Next came the planning of the nature of credit delivery in terms of marketing plans and associated expenditures, collateral requirements (including conditional waivers), documentation requirements, general and other specific tests of creditworthiness, the mode of loan disbursement, and the method and timing of repayment, with clear directions for refinancing or liquidating a loan. Monitoring of such loan facilities and usage created the next cycle of information acquisition and planning. The credit operations department was in charge of corporate finance (excluding priority sector, tea and sick unit advances). It not only had to sanction, monitor and follow-up on all aspects of lending, but also had to devise special ways to accommodate the concerns and needs of the borrowers. Some of them would be letters of credit, while some would be in the form of bank guarantee, deferred payment guarantee, other substantive and subsidiary, facilities, and so on. In particular, the department was responsible for a suitable monitoring system to get feedback in respect of large borrower accounts to ensure effective credit planning. The department was geographically divided into three areas, as given in Appendix 4.3. The reconstruction and counselling department was restructured in view of the fact that socialization of banking would require a quantum increase in the growth of deposits and advances and a significant proportion of advances to non-priority sector industrial borrowers would be hard to recover due to recessions, industrial stagnation, increased competition and many other unforeseen contingencies. In the case of priority sector borrowers, it was recognized that refinancing a sick unit would yield higher social welfare than simply liquidating its assets. Thus, the department was to identify sick but viable units among large sick or weak industrial borrowers, chalk out a suitable nursing programme for revival or rehabilitation, and ensure implementation of the programme in coordination with other banks and term lending institutions. From the early days, the bank had a strong portfolio in tea and had acquired considerable expertise in tea financing. To consolidate this historical comparative advantage, a separate tea department was thought appropriate as part of the credit wing. The tasks delegated to the department were the sanctioning, monitoring and follow-up on all individual accounts in tea gardens or industry falling within the purview of the Head Office and periodic reporting to the Board of Directors for each such advance account. The organization of the credit department was neatly done, keeping in view the various aspects of the credit cycle process, especially with regard to priority sectors. However, though the credit wing learned very soon how to expand the scale and scope of credit operations in the priority sector, it was not well equipped to handle situations of worsening credit repayment in different priority sector areas. Two factors were responsible for this: one, the overemphasis of government directives in credit creation, irrespective of the commercial rate of return and, second, delinking the credit wing from the recovery wing. The first factor was dangerous enough for prudential banking, while the second factor removed, to a large extent, the accountability of the credit wing since it could shift the blame of poor recovery to the recovery wing.

The recovery department was all about litigation since the very beginning. There were cases fought in courts and, later, also in bankruptcy tribunals. Most of the cases resulted in some compromise formula arrived by the borrowers and the bank, and some of the weak borrowers had to be taken for financial restructuring.

The inspection and vigilance wing had two functions—audit and reporting. Audit would be of three types—internal audit, external commissioned audit and RBI audit. The inspection department would handle all matters related to audits. The internal audit would be on a periodic and regular basis, including concurrent and rapid inspection. Inspection manuals had to be prepared and updated according to contingencies. The customer complaints division would attend to complaints received from the public, either indirectly through the RBI or the Ministry of Finance or directly through the regional offices and branches. The branch reconciliation department carried on its earlier activities as before, in terms of reconciliation and consolidation of books of accounts at the different branch levels as well as reconciliation of the bank's accounts with the RBI, SBI and other banks. The vigilance department was set up to handle all matters relating to frauds, fraudulent activities, misappropriations, and so on. There would be some small irregularities as is common in any bank, but the efficient process of vigilance at UBI, and the general honesty and integrity of the employees ensured that the bank would maintain a clean record.

Appendix 4.1

Head Office Organization Chart



Appendix 4.2

Activities of the departments under the ED

1. Merchant banking department
   (*a*) Public issue management and underwriting
      (*i*) Assisting in preparation of prospectus and obtaining approval of stock exchanges and institutional underwriters as well as obtaining credit rating from the credit rating agencies. Filling the prospectus with the Registrar of Companies.
      (*ii*) Stock Exchange clearances and listing arrangements.
      (*iii*) Arranging and coordinating the activities of underwriters, brokers, issue houses, financial institutions, bankers, and so on.

- (*iv*) Planning and coordinating publicity strategy and advertising budget.
- (*v*) Launching publicity campaign, holding press or investors' conference for invoking public support for the issue.
- (*vi*) Assisting in printing and despatching required stationery, brochures, pamphlets, and so on.
- (*vii*) Advising on quantum, nature and timing of the issue.
- (*viii*) Preparation of budget for the expense of the issue.
- (*ix*) Monitoring and coordinating the issue.
- (*x*) Collection of funds and compilation of details of subscription and assistance in proper allotment or refund or issue of share certificates.

(*b*) Project finance and loan syndication

- (*i*) Review of project profile and technical feasibility through selected consultants.
- (*ii*) Financial study of the project and preparation of viability report.
- (*iii*) Advise on the framework of institutional guidelines and laws governing corporate finance.
- (*iv*) Providing a cost-effective comprehensive package of means of finance based on the above framework and the requirements of the promoters for all schemes including modernization and diversification.
- (*v*) Preparing loan applications.
- (*vi*) Selection of institutions and banks to provide the means of finance.
- (*vii*) Arranging bridge finance.
- (*viii*) Negotiating with institutions and banks in close coordination with clients.
- (*ix*) Assisting in loan documentation.
- (*x*) Assessing working capital requirements.

(*c*) Portfolio management for non-resident investors

- (*i*) Advise on investment in securities, shares and deposits on both repatriation and non-repatriation basis.
- (*ii*) Advise on selection of investments.
- (*iii*) Obtaining approval from the Reserve Bank of India for purchase and sale of securities.

- (*iv*) Collecting and remitting dividend and interest.
- (*v*) Circulation of investment news.
- (*vi*) Arranging for tax consultancy services and filing of tax returns.

(*d*) General

- (*i*) To maintain close liaison with the Securities and Exchange Board of India (SEBI), various Stock Exchanges, brokers, financial institutions, and so on.
- (*ii*) To attend any other related work or as maybe assigned from time to time.

2. International banking department

(*a*) Vostro and Nostro

- (*i*) Execution of inter-bank payments
- (*ii*) Inward clearing
- (*iii*) Coding of BARs for computer
- (*iv*) Noting of *stop payment* instructions for rupee accounts maintained at the International Banking Division
- (*v*) Issue of inward remittance certificates
- (*vi*) Correspondence relating to Nostro and Vostro accounts
- (*vii*) Monthly reconciliation of Nostro accounts and follow-up thereof
- (*viii*) Review of FD reconciliation

(*b*) Foreign currency dealings

- (*i*) Cover operations
- (*ii*) Liquidity management
- (*iii*) Funding of rupee accounts
- (*iv*) Foreign exchange trading
- (*v*) Maintenance of mirror accounts
- (*vi*) Feedback on currency movements
- (*vii*) Rate calculation
- (*viii*) Review of dealing function of FDs
- (*ix*) Residual work

(*c*) Backup for dealing operations

- (*i*) Maintenance of positions
- (*ii*) Payment of brokerage
- (*iii*) Preparation of statements
- (*iv*) Inter-bank settlements

(*v*) Rediscounting of export bills
(*vi*) Travelling checks
(*vii*) Rupee drawing arrangements

Appendix 4.3

Geographic division of the credit operation department

Name of Department or Division	*Will Attend to Credit Proposal or Advance Matters Relating to*
Credit Operation-I	Calcutta-I, Calcutta Central, Calcutta north, Bihar North, Bihar South, Bihar-III, North India and Central Regions
Credit Operation-II	Calcutta South, Western, Southern, Orissa-I and Orissa-II Regions
Credit Operation-III	Howrah, Hoogly, 24 Parganas North, 24 Parganas South, 24 Parganas Central, Nadia, Burdwan, Midnapore North, Midnapore South, Purulia, Malda, Murshidabad, North Bengal, Central Assam, Nagaon, Sibsagar, Dibrugarh, Cachar, Purbanchal, and Tripura Regions as also the branches under direct control of Guwahati Zonal Office

Notes

1. *Banking Plans*, op. cit., pp. 95-96.
2. ibid.
3. Dutt, address to FICCI, 1971.
4. Dutt was not happy with the way events turned up and he frequently made his frustrations known after his retirement, but that is another story which we will pick up in the later chapters.
5. The intermediate level or the zonal and regional levels were especially important keeping in view the responsibilities of lead banking.
6. There were also the Estate, Official Language Division and the Premises Department under the direct charge of the Deputy General Manager.
7. Keeping in view the requirements with regard to knowledge inputs, development of operational skills and new developments in the area of bank management.

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5

THE YEARS OF DEVELOPMENT BANKING

In contrast to the years of private banking from 1950 to 1968, productivity and profitability of banks were not the exclusive indicators of banking efficiency anymore. With nationalization, the attention was turned to how fast a bank could expand its branch network, the rate at which it could mobilize deposits, and how efficiently it could disburse advances funds for the *priority sectors* like agriculture and small-scale industry. As explained in detail in the previous chapter, the organization was restructured to meet these contingencies. But it was left to the ingenuity of the bank management to realize the potential of the redesigned organization. Much depended on the extent to which the idea of development banking was appreciated and adopted by the rank and file in the banking hierarchy. The top management had to prepare plans for deposit mobilization and priority sector advances, keeping in mind the problems and opportunities at the branch level. The branch managers had to operationalize the plans through efficiently responding to local prospects and judicious relationship banking practices. The employees of all ranks had to be productivity conscious and provide cooperation. The United Bank of India (UBI) was already acquainted with the notion of social banking. Dutt had tried the concept of social banking even during the years of private banking with mixed and curious results, as mentioned earlier. However, the dream of nationalization was much wider and bigger in scale and the concept of development banking was an arduous challenge to a bank not used to agricultural or small-scale industrial finance in a big way. Pessimists who disparaged the notion of banking at the expense of the shareholders' profits would see a greater danger in nationalization—that the commercial orientation of banking would be permanently damaged. There was much debate about the issue with little agreement on the appropriate compromise between the social role of banking and its commercial orientation. However, this did not deter the nationalized banks from embracing and operationalizing the concept of development banking. In this chapter, we shall see how UBI grew to shoulder the new responsibilities and how it became irreversibly involved with the economic development of the eastern and north-eastern states.

Nationalization Paves the Way for New Dynamics of Growth

Between 1969 and 1976, the average population per bank branch office of the nationalized banks came down from 65,000 to 26,000. Under the slogan of nationalized banking, a financial revolution was sweeping through the country. On the liabilities side, the deposit contracts offered significantly higher incentives and the ability to save for the majority of small and fixed income group people allowed variable income group to accumulate as and when they received income in excess of their expenditure and channelled the savings of the high income group to banking by providing a risk free rate of interest, which was higher than that of the risk adjusted rate of government and corporate securities. On the assets side, the growth came through providing credit to farmers who were previously dependent on usurious moneylenders and significantly credit rationed prior to nationalization, relieving indebted households with refinancing at low interest rates, lifting small farmers out of poverty traps, making provision for financing irrigation facilities, and making sustainable development and repayment possible for farmers, small-scale entrepreneurs and self-employed people. What the chapter illustrates in terms of impact of development banking is clearly borne out at the aggregate level for all nationalized banks. Pandey and Burgess (2005) show that controlling for other factors, the standard poverty indicator and the head count ratio has fallen significantly in response to bank nationalization. Similarly, in the case of West Bengal, it has been argued that apart from the effect of land reforms, the medium term agricultural credit for financing tube well irrigation had a major role to play in the agricultural growth since the mid-1980s (Rogaly et al. 1999).

However, there were significant inter-regional disparities which kept on persisting over time as the banks tried to avoid the difficult terrains of low yield, underpopulated and underdeveloped areas, and less profitable clients like small farmers, sharecroppers and landless labourers (Ghosh 1979). Some of the regions like the north-eastern states were one of heavy casualty of the selective branch expansion programmes of the banks and would have suffered even more but for the branch expansion programme of UBI in those areas. The United Bank of India was different from other nationalized banks in the sense that instead of shying away from underdeveloped regions and activities, it actively promoted branching, deposit mobilization and lending in those areas. This was mainly attributable to the vision of the top management, particularly B. K. Dutt, on the social and developmental role of banking. From the very beginning of the lead bank and branch expansion programmes, UBI took on the most under-banked districts as the lead districts of the bank. To a certain extent, this was imposed on the bank which had already some networks in the eastern and north-eastern states, but the bank did not try to avoid the lead bank responsibilities in districts which were underdeveloped, and where deposit mobilization and credit repayment potential were low. Before we begin to recount the story of the overall growth of the bank, it is important to note this aspect of the growth process, since it will serve to put a better perspective on the performance of the bank. Another factor that one has to keep in mind is the deterioration of the industrial relations at the bank during this growth phase.

For UBI, the compulsion to accelerate the pace of branch banking and mobilize resources and engage in financial deepening of the economy at the countryside, while at the same time achieving prodigious targets in priority sector lending, created the motivation and incentives for a growth pattern which was unprecedented and unmatched by that achieved in the past. The organizational restructuring and coordination mentioned in the previous chapter, proved to be of great aid in supporting such a growth ambition. This growth is even more remarkable in the context of the de-industrialization of the eastern region and particularly the state of West Bengal, a process which really began around the time of nationalization (see Table 5.1). There are very few instances of extremely high rate of growth of the banking industry in the midst of regional industrial decline. It shows to what extent agriculture was credit rationed in the pre-nationalization era. It is important to note that the focus of the bank's lending policy had to shift to an extent anyway to other states in the east, where development opportunities were available, and to other sectors like agriculture and small-scale industries, as the industrial sickness spread in the industrial front in West Bengal.

Table 5.1 Registered factories—percentage regional share

	1948–49	*1958–59*	*1968–69*	*1978–79*	*1987–88*
Eastern region	34.72	27.44	21.58	15.10	12.02
Western and Central region	23.81	25.04	35.70	35.70	28.72
Northern region	17.53	19.61	16.36	16.36	23.87
Southern region	23.94	27.90	26.36	26.36	35.39

Source: Bengal Chamber of Commerce publication on West Bengal economy.

Capital started flowing out of West Bengal and the other eastern and north-eastern states in response to bankruptcy led closures due to idiosyncratic shocks to firms, closures due to general industrial sickness, closures created due to worsening industrial relations like strikes and lockouts, and those caused due to deteriorating law and order conditions (particularly in the north-east). However, the bank did not take any precautionary action in response to this situation to diversify its operations significantly all over India, with decreasing reliance on eastern and north-eastern India. We have already discussed some probable reasons for the bank not being able to diversify sufficiently in the pre-nationalization era. Some of those conditions like cultural differences, entry deterrence tactics pursued by powerful incumbent banks in other states, difficulty of mobilizing or transferring deposits do apply equally well in the post-nationalization era. However, it is also true that had the UBI exhibited a more aggressive strategy and selective diversification tendency, instead of passively accommodating whatever a highly competitive banking market had to offer, it would have gained significantly in the long run, in terms of having a well-diversified portfolio spanning the greater part of the country and it would have had a far better risk-return-growth profile. Unfortunately, aggression was neither part of the bank's operational culture nor part of its long run strategic orientation. Having said that, it must be admitted that most of the Indian public sector banks have had biases in terms of regional coverage, sectors serviced and clients targeted. Even without interstate barriers to banking, geographic diversification is not an easy strategy or a certain outcome despite the best strategy and its implementation. Also, not everybody had the historical advantage and resources enjoyed by the State Bank of India group of banks. But for banks like the UBI, it was imperative and the chance to achieve something significant on this front was squarely missed. To the extent that Indian banks share this lack of success in geographic and functional diversification, the entire banking system was heavily overexposed to region specific and sector specific shocks; something known in finance as a risk that can be eliminated through suitable diversification. Today, in the world of modern banking, geographic and functional diversification through branching is not necessary; a bank in one region can invest in another bank through inter-bank deposits market, or, better still, by agreeing to swap cash flows that cancels risk.

Let us undertake a quick review of the nature of the bank's growth. On the eve of nationalization, the UBI had 174 branches. At the end of 1973, the number of branches stood at 409—this included six branches of the Hindustan Mercantile Bank Limited (established in 1944) which were taken over by the bank towards the end of 1973. By October 1975, the number of UBI's branches increased to 478. In other words, UBI opened about 50 branches per annum on an average since nationalization, as against about five branches per year during the period 1950 to 1968. This would indicate the dimension of the organizational effort that had to be put in to expand the branch network after nationalization. The initial thrust of branch expansion was coordinated ably by the Head Office and supported well by the mobilization of time and effort of the lower level employees who were assigned to the different branches. In particular, as many as 162 branches out of the 280 branches opened by UBI between July 1969 and December 1974 were located in far flung hitherto unbanked areas. More than half of the new branches were opened in rural and semi-urban areas.

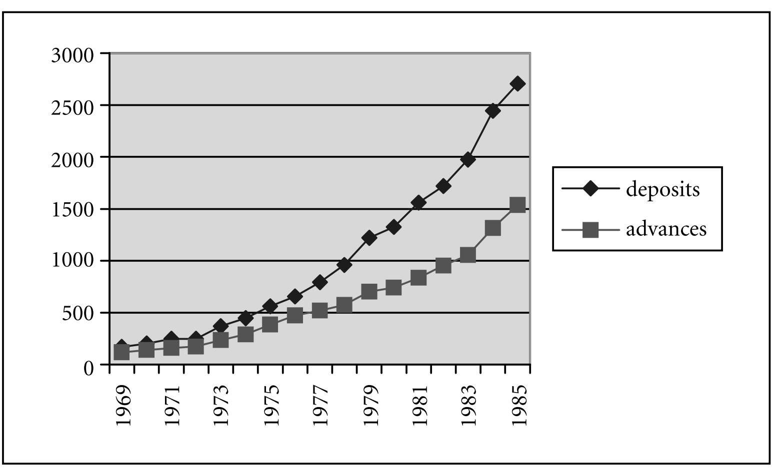
The deposits grew at a phenomenal average rate of 26 per cent and further the rate of growth was increasing over time. It is instructive to take a close look at the year 1970, as it marked a major thrust in the expansion of the bank and was representative of the direction of future growth. Nominal deposits increased by 21 per cent, though the rate of growth of real deposits was significantly lower (around 11 per cent) due to high rate of inflation during this period. This compared favourably with the earlier growth rate which was 16 per cent at the most. Noteworthy is the growth of fixed deposits (20 per cent). As we have mentioned before, this lengthens the maturity structure of liabilities and reduces the liquidity side risk of the bank. On the whole, it shows that the confidence of the public in the management of the bank was improving significantly. On the asset side, advances on an average grew at an increasing rate, though the rate of growth was around 17 per cent, that is, significantly slower than that of deposits, especially since the late 1970s, due to increasing investment in government securities by the bank and the growing fixed costs.

However, in the first few years of nationalization the situation was very different—the nationalized banks were busy branching extensively and intensively in the primary geographical areas that they served and there was a significant *spurt* in credit dispensation without a corresponding rise in deposit mobilization. Since deposit mobilization is much harder to achieve than disbursing loans before a bank branch office has put in the time and effort to reach the depositors with product development, advertising and marketing, it is no surprise that the growth of advances led deposits in the initial years. As a result, between 1969 and 1975, the ratio of marginal and average advances to deposits remained very close to unity, and the banks had to borrow money from the Reserve Bank of India (RBI) and the call money market, in order to service obligations on different fixed and variable assets. During this initial period, the branches were extremely busy in disbursing credit and the branch employees were stretched in terms of time and effort. The credit wing of the Head Office coordinated the activities ably through a process of communication, information processing and control. The directives of the finance ministry were converted into feasible credit plans and implemented through the branches by creating guidelines for credit disbursements, defining operations and assigning responsibilities to the branch managers. Feedback from the branches was taken into account to revise plans and operations.

The significant divergence between the growth of deposits and advances started from the mid-1970s and the difference kept on increasing due to a much higher average rate of growth of deposits as compared to advances (see Figure 5.1). One also has to bear in mind that by the mid-1970s, the branches (opened a few years earlier) were able to fully come to terms with the challenges of the financial landscape of the areas that they were supposed to serve. On the other hand, in agricultural and semi-urban areas, there was diminishing return to lending practices until the branch manager was willing to take significant risks. However, the ratio of advances to bills discounted kept rising all the time, indicating that advances were acquiring the most prominent place in the asset portfolio of the bank. That advances were rising at a lower rate than deposits and at a higher rate than investment indicate that fixed costs were eating a significant portion of the deposits mobilized.

The interest earnings were growing at a fast pace since the mid-1970s, despite the subsidy implicit in the differential rates of interest that scheduled commercial banks had to follow. In fact, the growth in interest earnings from the priority sector loans came more through the volume of advances rather than the lending interest rates, which were low in a financially repressed economy. On the other hand, the

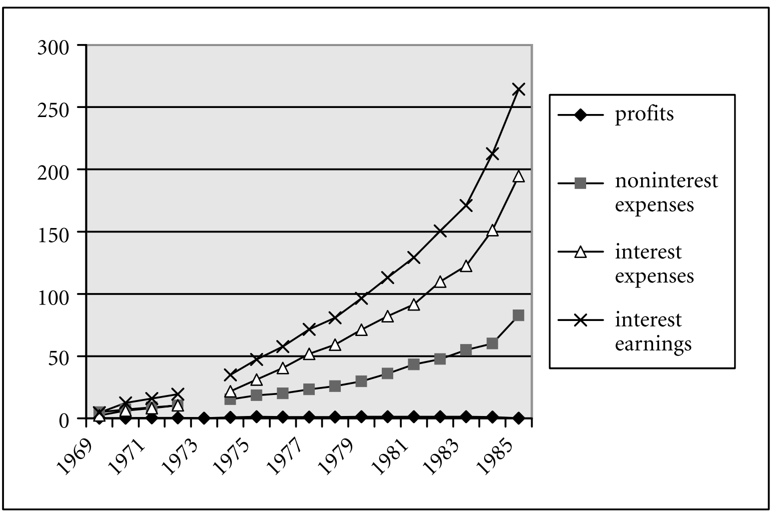
Figure 5.1 Growth of deposits and advances (in Rs crore)



Source: Compiled from the different Annual Directors' Reports, UBI.

interest earning from non-priority sector like the industrial loans, were attributable both to high rates of interest (averaging more than 15 per cent) as well as high turnover. Interest expenses became more important than non-interest expenses since the mid-1970s and grew parallel to interest earnings (the average interest rate on medium term deposits was around 10 per cent). This was so despite a higher absolute level and growth rate of deposits and is indicative of the fact that the interest on liabilities were low enough for a commercial bank with average efficiency to come up with significant profits. However, the absolute level of non-interest expenses was sufficiently high to wipe out almost all of the difference in interest earnings and interest expenses (see Figure 5.2).

Figure 5.2 Income and expenditure (in Rs crore)



Source: Compiled from the different Annual Directors' Reports, UBI.

At the risk of delving into the realm of counterfactual history, one can conjecture that had there been a policy of closure or restructuring of heavy loss making branches, profitability could have been pulled up to respectable levels, even in the middle of industrial sickness and an increased share of low-return priority sector advances. But the number of branches and priority sector advances were a performance indicator for the policy makers and it was no wonder that this created distortions in the growth path. Perhaps the concept of social and development banking would have been better integrated with the commercial aspects of banking, if there were prescriptions and requirements imposed by the Ministry of Finance on the required rate of return on capital, internal rate of return and cash flow indicators. Though some circulars paid attention to the profitability criterion with respect to branch expansion programmes, they lacked the rigour and the comprehensiveness necessary for proper commercial orientation of banking. It was not that profits had to be very high; what was necessary was the economy and operational efficiency (profit per employee and business per employee) which could only be achieved through pursuit of profit and value maximization. Such value maximization would have satisfied all the stakeholders—unfortunately, this was not to be. Despite growth, profit orientation and value creation, culture was absent in the bank, as too much emphasis was placed on the social welfare aspect of priority sector lending and as the industrial relations went out of control. The cost of excessive branch expansion and subsidized priority sector lending were not placed within a framework of reasonable commercial orientation. Militant labour union wrested some short-term advantages from the bank management, but in the long run, both constituencies suffered. Critics who had earlier voiced apprehensions about bank nationalization found their worst fears vindicated. Another utility of value maximization and profit orientation was that it could act as a buffer against future balance sheet shocks. Developing a reserve fund out of undistributed profits could have stood the bank in greater stead in the middle of the non-performing assets (NPA) crisis in banking which was witnessed in the 1990s. Unfortunately, neither the regulator nor the bank saw the value of accumulating profits in this way.

Consistent with the need for financing the developmental efforts of public sector agencies and the government, UBI had been adjusting its fund allocation. Hence, in the event of poor performance by the public sector units, the bank was likely to suffer. Since the public sector firms were not commercially oriented, let alone being dictated by the profitability criteria, the bank's exposure to risk was significant and could not be avoided. As many of these units turned sick and defaulted, they contributed significantly to the NPA problem, as we shall see in the next chapter. At the end of 1974, the government and public sector agencies were utilizing about 41 per cent of the UBI's deposit resources.

The banks' advances at the end of 1976 stood at Rs 473.00 crore. The emphasis on increasing the share of the priority sectors in our credit portfolio was continued. The priority sectors accounted for 29.9 per cent of the incremental credit in 1976. The share of the core sector industries in the incremental credit worked out to 11.5 per cent. The growth of the banks advances to the public sector undertakings during the mid-1970s is presented in Table 5.2.

Table 5.2 Advances to the public sector

At the End of (1)	*UBIs Advances to Public Sector Undertakings (Rs crores)* (2)	*Share of Public Sector Undertakings in Total Advances of UBI* (3)
1974	63.21	21.8
1975	105.99	27.5
1976	162.19	34.2

Source: Directors' Report 1976.

Another feature of the bank's credit portfolio was the diminishing share of large borrowers. A closer follow-up and control over the credit lines extended to the relatively large borrowers, in particular those having assets exceeding Rs 5 crore registered under the Monopolies and Restrictive Trade Practices (MRTP) Act, 1969, were continued during the year 1976. The declining trend in the share of the bank's advances to such big borrowers is evident from Table 5.3.

Table 5.3 Advances to large borrowers

At the End of (1)	*Outstanding Advances to the Undertakings Registered Under the Section 26 of MRTP Act, 1969* (2)	*Share of (2) in UBI's Total Advances* (3)
1974	Rs 50.54 crore	17.4 per cent
1975	Rs 63.57 crore	16.5 per cent
1976	Rs 77.05 crore	16.3 per cent

Source: Compiled from the different Annual Directors' Reports, UBI.

Complementary to the diminishing relative size of the bank's portfolio of big borrowers, was the growth of the bank's advances to agriculture (broadly defined), the small-scale sector, transport sector, retail trade and self-employed people. The growth of the bank's advances to the different priority sectors during the first decade of nationalization is indicated in Table 5.4.

Table 5.4 Advances to priority sector (amount in Rs lakh)

Sector	*June 1969*		*June 1979*	
	No. of A/cs	*Amount Outstanding*	*No. of A/cs*	*Amount Outstanding*
Agriculture	583	174.80	3,96,207	5892.74
(a) Direct finance	558	82.00	2,35,258	4112.55
(b) Indirect finance	25	92.80	1,60,949	1954.99
Small-scale industries	602	380.90	39,617	6690.89
Road and water transport operators	41	11.50	20,976	3277.70
Retail trade and small business	325	82.70	59,836	2295.62
Professional and self employed persons and education	2	0.10	15,326	480.60
Exports	187	355.70	397	3708.62
Total	1,740	1005.70	5,32,359	22520.97

Source: Compiled from the different Annual Directors' Reports, UBI.

The predominantly rural focus in branch expansion notwithstanding, the UBI management kept their interest in urban banking alive. The management noted that while rural banking had immense potential and was a social responsibility of the bank, the rate of deposit growth was higher in the urban areas. From the short term point of view of achieving a balanced deposit growth, it was therefore necessary to open some more branches in the metropolitan cities of Delhi, Bombay and Calcutta. Thus, this was not only the era of social banking but also a period of more intensive urban banking, which helped channel the marginal savings into investment. It must be mentioned that during this period, the liberal policy of the RBI regarding setting up urban branches helped considerably.

Growth in the rural areas came through various innovative measures adopted by the bank; increasing publicity was one example. There were intensive rural publicity campaigns in the lead districts. Hoardings were used in select rural areas. Increasing use was also made, of small periodicals and other magazines published from various district towns as publicity media. In some of the district towns in West Bengal, arrangements were made with newspaper agents for distribution of the banks' publicity and promotional literature along with the newspapers. To attract savings of the rural people, a prize scheme for depositors was also organized at five newly opened branches. Informative posters for the guidance of prospective small entrepreneurs were displayed at various exhibitions in which the bank participated. Alongside rural publicity efforts, special campaigns through attractively designed hoardings were launched during the year in cities like Kolkata and Guwahati, which caused widespread interest among the intelligentsia and common people alike.

An innovation that highlighted the uniqueness of the UBI's approach to development banking was the concept of floating banks—launches which would disburse credits and mobilize repayments at different points across the unbanked and inaccessible riverine areas of the Sunderbans. In 1976, UBI introduced two floating banks—one based at Nazat on board MV Rupasi Bangla and the other based at Namkhana on board MV Banani Bangla. They called on 12 islands on fixed days of the week and, in a short period, were able to improve the economic condition of the cultivators and small businessmen.

Another innovation was the operation of treasury chests by the bank. Some progress was made in 1973 with regard to the bank's assumption of the treasury work of the state governments. Three branches in Manipur, two branches in West Bengal and one in Assam were selected for handling the treasury work at the respective district headquarters of the state. Some branches were also assigned the duty of collecting central excise duty at the respective centres. The bank was also assigned to collect the railway revenue at 11 centres—five in West Bengal, three in Assam, two in Orissa and one in Bihar. The year 1973 also witnessed the installation of currency chests at the branches. Arrangements were made with the RBI for installing the chests in 36 branches of the bank.

In the meantime, there was a change in top management. After long 43 years of intimate and eventful association with the bank, Shri

B. K. Dutt, from 1 August 1973, went on leave preparatory to retirement from his office of Chairman and Managing Director of the bank. Kind and sincerely grateful words were showered upon Mr Dutt by the staff and the officers of the bank. The overwhelmingly emotional moment of paying respect to the founder of the bank was made all the more memorable due to the posters on the walls which saluted Dutt for all he had done for the bank and the banking community. With the retirement of Shri Dutt, Shri M. Sen Sarma, former General Manager, assumed charge as the Chairman and Managing Director of the bank. P. K. Sen became the new General Manager at that time; Shri G. H Dhar was the chief officer of the credit department at that time, with Mr A. K. Roy being the legal advisor. In 1973, the bank also had the new 18-storeyed Head Office building at 16 Old Court House Street, inaugurated by the then Union Finance Minister, Y. B. Chavan and presided over by the then Chief Minister of West Bengal Sidhhartha Shankar Ray. While entering the Dalhousie (corporate office) area, the tall white building was (and even today is) unmistakeable in its grandeur and the mystic conservative charm of the financial industry. It was also a reflection of the towering personality of Mr B. K. Dutt. When being presented with a silver replica of the Head Office building by his colleagues he felt that it was '…a replica of my ego but it also gives me a great sense of fulfilment. I know that it was my ego and vanity that led me to construct the building, but there was a great need for space and the building was functional and aesthetically laid out' (1994: 138). The building was a true bank Head Office with fine furniture, wall-to-wall carpets, a lush green lawn on the 5th floor overlooking the Chairman's Office, an excellent lunch room and a well laid out canteen serving wholesome food. The signs of growth and prosperity were all too evident as the number of facilities, services and people amplified from the Head Office to distant branches. However, the growth came at an enormous cost to the bank—the bank management found themselves hopelessly placed with respect to managing the burgeoning size of bank employees who were represented by militant unions.

The All India Bank Employees Association (AIBEA) led by the All India Trade Union Congress (AITUC) was the original union that engaged in representing organized labour to the banks and the United Bank of India Employees Association (UBIEA) was affiliated to AIBEA.

With time, more than one union would appear in the political landscape of banking. During the tenure of Mr Muktalal Sen Sharma, the bank faced crisis with respect to organized labour for the first time since nationalization—problems were created by the National Council of Bank Employees (NCBE), an organization under AIBEA. Dutt recollects:

> I once wrote to my grand successor, the chairman of UBI, for permission to look into the old papers of the bank up to July 1973. He was kind enough to invite me to visit him. While I was waiting for him in his room, one of the leading troublemakers of the No. Two union came in to see me and asked me to return to my old job. I offered my services to the union if all of them agreed to form a consultative committee. Nothing came out of our conversation or my offer. Nothing will. The issuance of circulars by the management and the unions is not going to help. Once, a well-meaning Bengali leader said, 'If trade unionism cannot flourish without harming UBI, let it not.' He lost the election, though he came up in a big way later and was still there at the top of the AIBEA (1994: 100).

In 1976, some people from the NCBE would start creating chaos almost daily. Further, an attempt was made that same year during the Emergency, to float a union by the clerks and the sub staff known as the Shramik Karmachari Samiti (SKS). The troubled officers of the bank felt that AIBEA was not representing the personnel of all sections of the bank in an adequate and symmetric way. In 1977, Mr Sushanta Neogy came in as the new chairman. He encouraged the officers to cooperate and get together and develop a feeling of solidarity. During his time, the Officers' Union was created at his initiative. It was known as the 'Officers Club' and had the same strength as the SKSS. Mr Neogy played a positive role and restored harmony in industrial relations to a certain extent. In the late 1970s, AITUC was broken by the CPI(M) and the Bank Employees Federation of India (BEFI) was created. Thus, there were four associations or unions. Initially the management only recognized AIBEA, but over time, the other associations came to yield power in terms of being heard and in being able to make demonstrations. This was done by means of all the associations forming a joint consultative committee. However, the different approaches and needs of the different associations could not be reconciled with the position of the management and created tensions which began to disturb the morale of the workplace at the branches. After the fall of Janata Government, another union was formed, namely, United Banks' Employees Union, a registered organization of BEFI. This organization had very little support from the bank or the employees. So they organized a movement with the support of outside people. In 1979, they started a 69 days stay-in-strike, capturing the 5th floor of the bank's Head Office. Almost all of the branches were affected by the movement. The strikers were confronted with opposite camps of the movement who sought to evacuate the strikers by force. As a result, a fierce fight took place at the bank premises and many people got injured and were admitted to the hospitals. It was a black day in the history of the bank. In early 1980, the SKS members created trouble through demonstrations such as forced *gheraos* and *dharnas* at the Head Office and the branches. All these incidences took place on 15 May 1979 and 7 March 1980, despite the bank having sought High Court orders under Article 226 directing that there should be no unlawful disruption of work. But the protestors violated all orders and at least 28 cases of violation by employees of the different unions were reported. The situation deteriorated so much that the chief executives of the bank stopped going to the Head Office and had to conduct business from elsewhere. On 12 March 1980, the matter was taken up by the Calcutta High Court and due to the conflicting reports by the management, unions and the police regarding the violation of the previous orders, Juctice R. N. Pyne, on the suggestions of the bank's counsel Mr S. Roy Choudhury, directed that a special officer of the High Court be stationed at the Head Office of the bank to make sure that the orders of the Court were complied with. Mr Ranjit Dutta was the CMD during that time and he maintained good relations with the AIBEA. Since the AIBEA was the only workers' union in the UBI, it faced and shared many crises shoulder to shoulder with the management. The good relationship was somewhat broken when new officials and professionals joined the bank after nationalization who had no historical relationship or extra obligation with the AIBEA. During the tenure of Mr K. L. Roy as the bank chairman, the situation got worse. Mr Roy kept a distance with the employees union and could not achieve credibility in their eyes. During the period of Mr C. R. Sengupta, the bank made a distinguished effort to turn away from the prevailing chaotic environment. He coined the slogan *Amra Abar Pragatir Pathe* (We are again on the path of progress). He began to take stern action against people who were involved in creating disorder and indiscipline in the office. Demonstrations were restricted. He was successful in resolving some tension on the labour front though problems would erupt from time to time. At times, he was not able to enter the Head Office or the office at Deckers Lane. During such times, he would continue with the official work from a secret place. However, even he found the growth of the bank difficult to manage with a reasonable degree of efficiency. Growth could not be compromised even in those troubled times. So much time had to be spent on industrial relations like negotiations and disciplinary actions, and on administrative issues like sending detailed orders to branch officers to keep their houses under control that the monitoring effort in the advances department suffered a great deal. Not surprisingly, there were some allegations about bad advances during his tenure.

Comparative Performance

The United Bank of India is towards the bottom when one arranges the banks in terms of number of branches. However, in terms of deposits and advances, the bank's ranking is in the middle. This indicates a higher amount of activity per branch relative to many other banks, which bears positively on the bank.

The advances to deposits ratio for the bank was declining faster than other banks and the average ratio for the period was one of the lowest among all the nationalized banks. There were two main factors responsible for this—one, the fixed costs of operations of the bank was rising throughout the period and the other was that the average size of an advance account was much lower for the bank, which tried to cater wholeheartedly to reach the small and marginal sectors.

All the banks (and UBI was no exception) were operating with extremely low capital to deposits ratio. In other words, the government was taking a significant amount of risk through the commercial banking system. One wonders whether the banking system would have been better served with a system where banks held a proportion of firm equity for any given level of credit sanctioned. Certainly, this would have had the effect of at least partially insuring the banks and, ultimately, the taxpayer for the kind of risks that were involved. The United Bank of India for one, always preferred taking over the management of a company in case of a default which only put a bound on the prospective losses but did not allow any additional profits to be made during good times. The reserve deposit ratio was kept quite high by the monetary authorities who ensured a built-in prudence in the system, but this did not take away the risky nature of the priority sector loans.

Deposits were predominantly mobilized in West Bengal, though Maharashtra had a fair share in the effort. In terms of utilization of deposits UBI fared well compared to other banks. In terms of regional distribution, advances were less asymmetrically distributed than deposits, with the noticeable feature being a high share going to Maharashtra.

As far as the ratio of priority sector advances to total advances was concerned, West Bengal had a low average of 22 per cent in 1979 (as opposed to higher ratios observed in Bihar [49.7 per cent], Orissa [49.9 per cent] and Haryana [60.9 per cent]) (Angadi 1983). The ratio for UBI was around 33 per cent in 1979, thus reflecting more intensive priority sector operations relative to other banks in West Bengal.

Profitability remained a particular concern for the nationalized scheduled commercial banks, while the State Bank group showed higher gross and net profits and a higher growth rate of profits in the 1970s. In particular, the growth rate of profits for the State Bank of India (SBI) group was 26.4 per cent while that for the group of 14 nationalized banks was merely 17.2 per cent (Verghese 1983). Though in the 1980s the growth rate of profits increased for some of the nationalized banks, that for UBI was only following a Hindu rate of growth, as witnessed in the earlier two decades. In terms of productivity or profit per employee, the SBI group was ahead of the 14 nationalized banks throughout the 1970s; while for the former there was a relative decline (Rs 7,967 in 1976 to Rs 7,820 in 1980), for the latter group there was an improvement in productivity (Rs 4,362 in 1976 to Rs 5,894 in 1980) for the second half of the decade (Angadi and Debraj 1983). While many individual banks were catching up with the standard set by the SBI group, UBI was not among them.

Mobilizing Deposits

On the eve of nationalization, there was much apprehension whether the banks would be able to meet the priority sector credit demands by significantly lifting their deposit mobilization efforts. When in 1969-70, the growth rate of deposits declined relative to the previous year, thus leaving banks to borrow from the RBI or the call money market to finance their additional lending, the apprehension turned into a mild panic in the financial and policy circles. Many innovative ideas were floated regarding how banks could increase their growth rate of deposits and some of them entailed linking deposit payments to future loans at low rates of interest (deposits could finance, for example, housing loan, education loan, marriage loan, medical loans, and so on) and deposits that would entitle the holder to services like insurance, portfolio management, debit cards, social security, and so on (Bhatt 1970). There were also suggestions for proper econometric studies of causes of deposit growth, with special reference to behavioural variables like real interest rates on deposits and deficit financing, and measures of institutional aspects like savings habits, planned branch expansion and tax evasion (Bagchi 1971: 841–844).

The demand for funds that bank nationalization warranted hiked up the interest rate structure of deposits—while prior to nationalization the interest rate on savings account was 3.5 per cent, it increased to 4.5 per cent to 5.5 per cent after nationalization. While previously fixed deposits yielded an interest rate of 6.5 per cent, it increased from 7.5 per cent to 8 per cent in the post nationalization decade. The gap in the case of longer term savings was even higher. The higher interest rate that the nationalized banks offered witnessed a tremendous surge in their deposit growth. Generally, however, the deposit growth of the nationalized banks came as much through higher interest rates as through branching in new areas. In the case of UBI, the success came as a result of a massive effort to reach out to the small and big savers through innovative deposit schemes that catered to the requirements of different clienteles. It targeted different fixed income groups, small savers or potential small savers, and the wealthy and middle class in different ways. Apart from this, banking was also fine-tuned to meet client requirements as the bank also projected itself as customer friendly on the liabilities side of banking. It tried to give an image that banking with UBI was not a daunting task for the customer and the customer could get help in enquiry, account opening, withdrawal, complaints, investments, reporting and timely payments of interest. The advertisements in the local newspapers projected UBI as 'the friendly neighbourhood bank' and a bank for the masses, while explaining how to open an account in the bank and how to choose among different schemes. Some advertisements appealed to the security of bank deposits and the beneficial impact that a bank has on households by developing their savings habit and growing their wealth. However, the bank did not stop at this, it used rural branch agents to canvass for deposits and take marketing and advertising to the people. In 24 Parganas, UBI used audio-visual campaigns at different villages, thus explaining advertising and marketing at one go to the rural people. The publicity unit organized exhibitions in huts, distributed leaflets and informative folders, played on a recorded programme of songs and drama on the theme of savings, and initiated group discussions. It achieved success as small-scale entrepreneurs, fixed income group people, pensioners, widows, farmers, artisans, and so on, joined the depositor base of the bank.

The warranted growth path required that one of the first tasks of a bank was to target the fixed income group in a big way. Targeting involved not only lucrative schemes but also developing the savings habit, especially the sense that bank savings can serve as an important substitute for self control in matters of spending or savings decisions. Thus ran an UBI advertisement in a leading financial magazine—

> For many of us in the fixed income group, the month begins with a bang. A spending spree or just that wee bit extra pressure on purse flows…. And the days start limping to that far away destination—the next pay day. But we cannot avoid spending on festive occasions, guests, social obligations. … Here's the UBI way out of the impasse. Open an account with UBI. Deposit your pay packet right at the beginning of the month—withdraw when you need it. This practice will gradually lead to some savings. Sure enough, you will be able to meet any unforeseen expenses on you own account and without worry. Keep your money secure with UBI. Cash at home has the peculiar tendency to evaporate quickly even under the normal circumstances!

The idea that bank deposits could serve as a means of savings while meeting whatever liquidity requirements of the individual was gradually spreading among the populace which had been shy or apprehensive about opening a bank account. This kind of advertisement tilted the balance in favour of deposits for many people who were previously just indifferent between the two options.

To attract the small saver in rural, urban and semi-urban areas, the bank took a number of steps. A savings account could be opened with a meagre sum of Rs 5 and a number of withdrawals were permitted each month. The bank advertised the scheme in the local newspapers and sent agents to collect savings from farmers, artisans, and so on. This was a significant step in development banking since it increased the habit and incentives for small savings for the average Bengali family.

By 1972, the bank had more than one million depositors. It kept on increasing the *small depositor* base at a very fast pace, through branch expansion and innovative schemes advertised creatively. Its 'Recurring Deposit Scheme' became very popular from 1972 onward. Under this, individuals did not have to initially produce a large sum but could accumulate through small (between Rs 5 and Rs 500 in multiples of five) recurring sums while the savings grew at healthy compound rates. In this way, the savers could save small amounts (whose opportunity cost was insignificant) and see the saving grow to a useful sum. Table 5.5 shows how it worked.

Table 5.5 Recurring deposit schemes

Monthly Deposits Rs	*Depositor gets after 48 Months*	*Depositor gets after 60 Months*	*Depositor gets after 80 Months*
5	277	360	518
10	554	720	1036
20	1108	1440	2072
25	1385	1800	2590
50	2770	3600	5180

Source: Compiled from the different Annual Directors' Reports, UBI.

To promote long term savings, UBI floated a 'Monthly Income Fixed Deposit Scheme' from early 1970s. The scheme required a deposit of Rs 3,000 and above for a minimum period of three years. The benefits started accruing from the next month after the deposit was made and the holder could draw interest income keeping the principal intact (see Table 5.6).

Table 5.6 Monthly fixed deposit schemes

Deposits	*Monthly Income on Deposits for 3 Years*	*Monthly Income on Deposits for 5 Years*	*Fixed Deposit Interest Rates*
Rs 3,000	Rs 16.25	Rs 18.12	3 yrs—6.5%
Rs 10,000	Rs 54.17	Rs 60.42	3–5 yrs—7%
Rs 50,000	Rs 270.83	Rs 302.08	Above 5 yrs—7.5%

Source: Compiled from the different Annual Directors' Reports, UBI.

This was a good way of supplementing one's income and enjoying a regular income on a monthly basis. Further, since fixed deposits increased the maturity structure of the bank liabilities, the bank wanted to grow its deposits through this and wanted to provide high incentives to savers to keep their wealth and income as fixed deposits. Later on, the maximum interest rate on fixed deposit was increased to eight per cent.

By 1979, the number of schemes for the depositors had multiplied and covered a variety of needs. Apart from savings accounts, fixed deposits and recurring deposits, there were many others. Cash certificates were being offered to promote long term savings and an individual could invest in a UBI Cash Certificate for seven, eight, nine or 10 years and watch it grow with a high average interest rate. For example, a certificate of Rs 500 yielded 1,217.75 after 10 years. There was a scheme called the Reinvestment Plan which kept on reinvesting the previous accumulated savings for fixed number of periods. The United Bank of India Reinvestment Certificates gave the maximum return for short-term deposits for 15, 24, 35, 48, 63 and 72 months. A reinvestment certificate of Rs 500 was worth Rs 853 after 72 months. Under Future Income Plan, one could save a fixed amount every month for a fixed period and enjoy a higher income every month for an identical period. For example, depositing Rs 100 every month for 120 months yielded Rs 243.55 per month. Some other schemes had features like pension and insurance. Under the Pension Deposit Scheme, if an individual deposited Rs 100 for 84 months, one could get pension of Rs 87 for the rest of her life. The deposit along with the interest remained intact and on death was payable to the legal successor. Under Insurance Linked Deposit Scheme, a deposit of Rs 500 or more for 63 months could earn interest and the deposit holder was given accident insurance coverage of up to Rs 12,240 without paying any premium.

However, while many of these schemes for depositors became successful in the rural and semi-urban areas, in the urban areas there arose problems in branches due to low employee morale and trade unionism. These branches became *employee* oriented instead of *customer* oriented and many depositors soon became disillusioned with the bank. This was also the time when many problems started at the asset side as the different important accounts in tea, heavy engineering, jute, and so on, began to show declining profitability. All this damaged the image of the bank as the bank of the eastern region.

The Experience of Agriculture Finance

Nationalization placed a heavy demand on the organizational methods and operational capacity of the bank, particularly in financing agriculture in rural areas. Here is an interesting innovation in operational finance:

> In agriculture financing, after some experience has been gathered and some progress made towards building up adequate organization for the supervision of end-use credit and for extension of service, it is now felt that the most effective way would be to go about it on a selective basis and with an area approach. A method has now been evolved by which clusters of potential borrowers located within an area or *anchal* are identified and attempts are made to bring the group as a whole under UBI's financing arrangement. It has been found to be operationally more convenient and effective than the earlier method which resulted in scattered location of borrowers, making it difficult to exercise the follow up control. The bank management felt that the major catalytic agents of growth in agriculture in the area of our operation are minor irrigation and inputs like fertilizers, pesticides and so on for high yielding varieties. With this end in view, the major emphasis in farm financing was placed on sanctioning equipment loans for minor irrigation and crop loans (Directors' Report 1970).

As far as farmers with small holdings were concerned, use of farm equipment like shallow tube wells and pump sets on individual basis was found uneconomic. Therefore, in order that the use of such irrigation facilities were to become economically viable for small farmers and to ensure optimum use of scarce water resources, UBI adopted the group loan scheme for minor irrigation. From the initial years of nationalization, this principle of extending finance collectively to groups of small farmers in a compact and contiguous area was put into operation. In 1969, the farmers of Soulaveri village of Midnapore district were assisted by the bank for buying pump sets and shallow tube wells. The bank sanctioned a loan of Rs 7,90,000 to 290 cultivators of that village. In July 1970, the bank advanced a loan of Rs 69,000 to 70 cultivators for the construction of a masonry well to irrigate lands under the Aman crop which was severely damaged by drought. The bank also came forward to help farmers cultivate a second crop in the Rabi season. After the failure of the Kharif crop due to water logging and flood in Raipur village, 24 Parganas, UBI sanctioned a loan of Rs 20,000 for purchasing electric pump sets and for the installation of shallow tube wells to 300 farmers. These were a group of landless farmers brought together to till the land of others lent out with the prospect of better returns than under sharecropping arrangement. In Mahula village, Murshidabad, UBI sanctioned a loan to 13 groups of farmers, each group consisting of 203 farmers. In Baranberia village, Nadia, the bank sanctioned a loan to 88 farmers for the purchase of pump sets and shallow tube wells. The liability of repayment in the last two cases was on a group basis. In 1972, the bank came to the support of drought affected farmers of Purulia and Bankura districts. One hundred and thirty wells were already constructed with bank assistance in Purulia, while 47 such wells were constructed in Bankura. In view of the seriousness of the situation, the bank offered financial assistance to build 103 more wells.

Apart from the *anchal* approach to financing, there were other innovations in agriculture finance undertaken by the bank. A noteworthy one was encouraging and assisting the establishment of agro service units or custom service centres which not only undertake the supply of necessary units for agriculture, but also provide maintenance and repair service and hire out equipment like tillers, threshers and tractors. This ensured that the UBI finance of the farm loan would generate adequate income by getting assured of these complementary services.

On repayment of agricultural loans the UBI management had an interesting observation:

> Our experience of ensuring repayment of the assistance granted to borrowers in this category has been rather mixed. It is seen that while in

> certain areas, by and large, repayments have been at a higher level, in other areas they have been far from satisfactory. While natural calamities in certain areas have been responsible for this situation, in other areas, a degree of inadequacy of organization and manpower to supervise the end use of credit and to establish personal rapport with the borrowers may also have contributed. An additional factor which we come across at times is the psychological expectations that have been created, over the years, by the experience of receiving credit from the cooperative sector and from State Governments direct, which has not been conducive to developing a satisfactory repayment habit among the rural borrowers. (Annual Directors' Report of UBI, 1974)

It was thus the increasingly politicized nature of farm lending which was emerging as the key problem. The problem has been a severe and a chronic one. It has affected the very purpose of loan disbursements. In a way, it reflects the political rather than the socio-economic objectives of the policy makers and mocks such credit programmes as hidden subsidy programmes. It is no wonder that many of these loans had been classified as non-performing assets (NPAs) and it is clear that the bank should not be made to bear these burdens on behalf of a fiscal system which has created an irresponsible repayment culture in this sector.

The bank's social burdens were manifold. The bank continued to provide increasing credit support to the people of small means in agriculture and allied activities, especially during the bad years of 1972 and 1973. An overwhelmingly large share of its direct finance to agriculture went to farmers having relatively marginal landholdings. As in September 1973, the distribution of UBI's direct finance to farmers belonging to different size classes of landholdings is as mentioned in Table 5.7.

Table 5.7 Percentage share of each class in UBI's assistance to agriculture (direct)

Size Class of Holdings	*No. of Accounts*	*Amount Outstanding*
0–2.5 acres	46.76	20.64
2.5–5.0 acres	33.46	41.40
5.0–10.0 acres	19.65	21.08
Above 10 acres	2.83	16.88

Source: Compiled from different Annual Directors' Reports, UBI.

There was a sharp decline in the average amount of outstanding advances to agriculture (direct) per account; the amount declined from Rs 1,169 in December 1972 to Rs 911 in December 1973, indicating the bank's continued emphasis on financing small and marginal farmers. This trend continued throughout the nationalization period. (This could not be said of all the nationalized banks. There was a negative bias in lending to small and marginal farmers as Mookherjee and Bardhan show in their analysis of the Integrated Rural Development Programme 2004.) While this had positive socio-economic ramifications, it increased the exposure of bank loans to risks arising from lack of savings of small farmers, seasonality of the weather, natural calamities and the tendency for small farmers to divert production loans to consumption purposes during economic hardships. As in June 1973, the average amount of outstanding advances to agriculture (direct) per account in case of UBI worked out to Rs 1,097 as against the corresponding figure of Rs 2,383 for all public sector banks. Table 5.8 shows the relative figures, in some of the states, in which UBI's agricultural financing was concentrated.

Table 5.8 Amount of outstanding advances to agriculture (direct) per account (Rs)

State	*UBI*	*All Public Sector Banks*
Assam	1437	1443
Bihar	1185	2492
Manipur	593	645
Meghalaya	582	779
Orissa	548	1046
Tripura	404	526
West Begal	1072	2316

Source: Directors' Report 1973.

It is clear that in the case of eastern and north-eastern states, UBI was focusing on small farmers. Except in the case of Assam, the amount outstanding per account was much smaller for the bank as compared to the rest of the nationalized banks.

The United Bank of India's financial assistance to agriculture was not confined to landowning cultivators only, but was successfully extended to sharecroppers and landless labourers as well. A number of sharecroppers of 24 Parganas district were financed by UBI during 1973, the number of accounts financed being 198 in the Kharif season and 155 in the Rabi season. It was felt that such assistance could be accelerated in the future especially with adequate support from the government. As far as landless labourers are concerned, mention may be made of the bank's assistance to a group of 50 in Midnapore district who were offered small plots of land by the government; they were able to find increased employment opportunities all the year round with the assistance that they have received from the bank. For increasing the income of the landless labourers through subsidiary occupations, a goatery scheme has been implemented in 24 Parganas district, under which 49 labourers have been assisted for the purchase of goats, construction of sheds and for meeting maintenance expenses for the initial six months. A dairy development scheme was also introduced with a view to assisting the small and marginal farmers supplement their income from land and small milkmen to raise their income from below subsistence level.

In 1973, the bank also made a beginning in helping educated unemployed youths in taking up agricultural occupations. Two farming cooperatives formed by some educated young men of Birbhum district of West Bengal were provided with short-term loans for cultivation of potato, mustard and wheat on land held by them on annual lease. This has provided employment to 21 members, including seven graduates and two diploma holders in engineering.

Apart from the obvious repayment problems, there were other important problems of farm lending. The going was not always smooth as the bank found several hurdles in smooth implementation of agriculture financing plans as summarized in an annual directors' report:

> In the course of the operation of our different schemes of farm financing, we have encountered a number of problems relating primarily to the cooperation of the different State government agencies. The following indicates the nature of the problems faced by us in respect of the operation of some of our schemes—
>
> (*a*) Non-availability of fertilizers in required quantity and the distribution policy of the State governments present a serious problem for our scheme of financing the farmers service societies. In West Bengal, it is often found that though the societies have stocks of fertilizers obtained through different

agencies, they cannot distribute them directly to their members, as they have to depend on the Block Development Offices because of the restrictions under the fertilizer control order. There was an added difficulty during the last season when the distribution of fertilizers was linked with the discharge of levy obligations. Since the small farmers were outside the purview of the levy, many of the small farmers assisted by us faced difficulties in obtaining fertilizers. It is felt that if adequate administrative and technical support were extended by the State government to the societies, it would have been possible for us to achieve much better progress in respect of the scheme for financing the societies.

(*b*) We have similarly encountered some problems in our efforts to enthuse the primary cooperative societies adopted by us to increase their membership and take up multipurpose functions. Byelaws of most of the societies have not been suitably amended so as to permit our participation in their share capital and management. The cultivable area under each adopted society is rather small and there is a need for the delimitation of the area through liquidation or amalgamation of adjacent societies for making the adopted societies viable. In the matter of appointment of the first managing committees of these societies, again, the banks were not consulted; as a result, the management of some of these societies did not adequately represent the small and marginal farmers. In some cases, again, the district central cooperative banks have been found reluctant to withdraw their finance, though the concerned primary cooperative societies are located in the areas identified by the Reserve Bank of India for the purpose of our adoption.

(*c*) In order to avoid duplication of finance, we had to withdraw our farm financing activities from areas where the cooperative agencies were also operating. For example, after overcoming some initial difficulties arising out of the existing inheritance laws, we started financing the potato growers of Smith area in Meghalaya in 1971. The national policy that was subsequently accepted required that only one financial agency, either a cooperative society or a commercial bank, should operate in an area and where both the agencies were operating, the commercial banks could finance only those farmers who were not members of the cooperative society and after 'no objection' certificate had been issued by the society. In view of this, we had to withdraw our financing activities from the area, although the request for our continuing the activity is persistently being received from the local people.

(*d*) We have not been able to go in for financing dairy farming in a big way because of the non-availability of quality milch animals. State livestock farms do not give any preference to intending dairy loaners, including dairy cooperative societies, in the matter of supply of cross bred cows at their disposal. In some of the areas where intensive dairy development has been taken up by us, if services of additional veterinary surgeons were provided by the State government, it would have been possible to ensure adequate health care and avoid loss due to death and incapacitation of cows. Even in case of death of cows, the service of the veterinary surgeon for post mortem examination and report, which are essential for substantial insurance claims, is not readily available.

(*e*) Our experience in financing the Sericulturists in Malda district has been that there is a resistance on the part of the mulberry cultivators to install shadow tube wells with our assistance. There is also an acute dearth of disease-free seeds. If effective cooperation from the Sericulture Department of the State government were available in this regard, the progress in respect of financing the Sericulturists would have been much faster (Annual Directors' Report 1974).

Financing Small-scale Industry

Since the very beginning of the nationalized banking era, UBI, in conformity with its tradition of serving the common people, took steps to ensure that people of small means are purposefully developed as viable borrowers. As a result, UBI's priority credit sector portfolio was gradually characterized by significantly low outstanding advances per account and a remarkable diversity of small-scale activities financed. The United Bank of India's assistance made an impact on the lives of the people of small means engaged in small industry, small businesses and other small-scale productive endeavours. A large number of people were able to get rid of the stranglehold of the usurers, be gainfully employed and improve their standards of living with the assistance of the bank. In its efforts for taking the banking facilities to the common man, the bank identified a large number of people engaged in many trades and professions who were in misery owing to lack of finance and proper marketing arrangements and consequently fell an easy prey to those thriving on the economic vulnerability of others. As these different groups did not fall into any set pattern, the bank had to study their needs and prepare special tailor-made schemes for each group in order to help them get a better footing in life. Mention may be made in this connection of the clay modellers, handloom and powerloom weavers, vegetable vendors, *paan* vendors, fish vendors, wooden handle makers, rickshaw pullers, tailors, cobblers, mat makers, basket makers, *bidi* makers, cart wheel makers, silk reelers, silk weavers, ceramic product manufacturers, and so on. Credit support to the small industrial and business enterprises, especially where they are run by new entrepreneurs with little experience, required supplementation by non-financial assistance with respect to techniques of production, procurement of raw materials, marketing and maintenance of books and accounts. While UBI's branches render these services to the assisted units in a general way, a number of small business development offices were opened at various growth centres to provide exclusive assistance, of the nature indicated earlier, to the small entrepreneur borrowers. Commendable progress was achieved by the bank in respect of the 'Differential Rates of Interest (DRI)' scheme and 'Half a Million Jobs Programme'. At the beginning of nationalization, the DRI scheme was being implemented at 110 branches located in rural and semi-urban areas. Under the 'Half a Million Jobs Programme' sponsored by the Planning Commission, the bank assisted unemployed persons to make a living through productive self-employment as mini bus operators, auto rickshaw operators, and so on.

Since the very beginning, UBI paid special attention to the small-scale sector. During the year 1970, satisfactory progress was made towards assisting the small-scale industry, retail trade and other small businesses, professional and self-employed persons. For this group as a whole, the number of accounts increased from 8,875 at the end of 1969 to 26,610, that is, an increase of almost 200 per cent. Credit assistance to this group of borrowers increased by 72 per cent. Outstanding credit on the other hand, registered an increase of over 118 per cent. The additional credit utilized by these borrowers amounted to 42.7 per cent of the accretion of deposits during the year and 63.3 per cent of the increases in advances.

Special thrust in small-scale industry financing by the bank came when the 'Differential Rate of Interest Scheme' was introduced on an experimental basis in July 1972. Under the scheme, bank finance was proposed to be made available at a concessional rate of interest of 4 per cent per annum to such borrowers as are engaged on a very modest scale in occupations like agriculture and allied activities, collection and processing of forest products or engaged physically in cottage industries and vocations in urban areas for which no adequate and dependable source of finance exists. The scheme was confined to the backward districts but excluded MFALDA and SFDA districts. The bank selected, for the implementation of the scheme, 40 branches, some of which were also outside the lead districts. As at the end of February 1973, the total number of accounts financed by the bank stood at 700, accounting for a total amount of Rs 2.66 lakh.

Apart from financing people of small means dependent on agriculture or cottage industry on a regular basis, in 1972, the bank formulated and implemented a large number of special schemes to assist groups of people who generally remained outside the reach of bank finance. These schemes were prepared to help these people earn full wages, to generate further direct and indirect employment, and to strengthen their bargaining capacity.

The bank has its due role in ensuring the revival of sick industrial units in West Bengal and the eastern Region. In 1971, the bank actively participated in this work with Industrial Reconstruction Corporation of India Limited. Ten units were under revival scheme in 1971. Besides the direct financial assistance, UBI has also extended help by relaxation such as reduction in margin and rescheduling of debt.

Regional Development

Consistent with the geographical spread of UBI's branch network, there was a concentration of priority sector lending activities of the bank in the eastern and north-eastern regions. In some of the states in these regions, UBI accounted for a large share of assistance provided to these sectors by the public sector banks. As in June 1973, the percentage share of UBI in the number of accounts and the amount of outstanding advances to the neglected sectors in these states were as mentioned in Table 5.9.

Table 5.9 Percentage share of UBI in all public sector banks assistance to neglected sectors at the end of 1973

	No. of Accounts	*Amount Outstanding (in Crore)*
Assam	39.5	27.3
Manipur	84.8	52.9
Tripura	80.9	68.6
West Bengal	57.4	31.8

Source: Annual Directors' Report 1973.

The bank was also increasingly associated with the agricultural development activities undertaken by the state governments, particularly in the eastern and the north-eastern regions. The Assam government constituted five agricultural farming corporations to assist selected landless agriculturists in the early 1970s through credit and input supply to undertake cultivation with modern methods on land allotted to them by the state government. The financial assistance to one of these corporations was extended by the bank. Besides, efforts at providing financial assistance to the other ones have been initiated. In West Bengal, the bank assisted the project report for agricultural development submitted to the World Bank. Discussions were held with the World Bank Mission and assistance rendered to them in the preparation of the project and the appraisal.

The bank contributed significantly towards achieving a decline in the population per branch office in the states in the east and north-east. In 1976, 41 branches were opened in the under-banked states of Assam, Manipur and Tripura, which accounted for 37 per cent of the total number of offices opened by the banking system in these states during the year. The population per bank office in Assam declined from 67,000 at the end of 1975 to 51,000 at the end of 1976. The corresponding figures for the states of Manipur and Tripura stood at 1.06 lakh and Rs 57,000 and Rs 77,000 and Rs 47,000, respectively. The bank continued to expand its deposits and advances in these under-banked states, thus contributing towards a reduction in the regional imbalances. Efforts were also made to increase the credit–deposit ratio in these regions. At the end of 1976, the credit–deposit ratio worked out to 88.8 per cent in Orissa, 86.1 per cent in Nagaland and 48.4 per cent in Assam.

During 1980, three more regional rural banks (RRBs) were sponsored by UBI, thus bringing the total number of such banks sponsored by UBI to seven. At the end of 1980, the total number of offices of these seven RRBs stood at 216, and their total deposits and advances were Rs 9.04 crore and Rs 9.31 crore, respectively. The major share of their advances, both direct and through the primary cooperative societies, went to the small and marginal farmers and landless agricultural labourers.

Development Banking and the 20 Point Programme

The year 1976 was particularly marked by significant developments which were expected to shape the future of the banking system in the country. A major development in this regard during 1976 was the appointment of a banking commission under the chairmanship of Shri Manubhai Shah to review comprehensively the organizational structure of the public sector banks and suggest such changes in the structure as would promote the operational efficiency of the banks and ensure their deeper involvement in the process of rural development. It was also aimed to implement the 20 Point Economic Programme—to secure a more balanced regional development in terms of the availability of banking services and deployment of funds, and establish closer links and coordination between the public sector banks and other credit and development agencies for formulating and implementing banking plans within the framework of national planning.

United Bank of India was one of the nine public sector banks allotted by the Government of India for the task of coordinating efforts for implementing the schemes under the 20 Point Programme in different states. UBI was allotted the states of Assam, Manipur, Tripura and West Bengal. The bank set up the state-level Bankers Committee in Tripura towards the end of 1976. The Committees for the other states were set up in early 1977. These Committees had representation from the commercial banks, regional rural banks, the state cooperative banks and land development banks and would consider problems requiring inter bank coordination such as areas of demarcation for implementation of different schemes implemented at the district level, as also the uniformity in the terms and conditions of credit under specific schemes being operated in different areas.

The efforts at reorienting the banks' credit portfolio in accordance with the objectives of the 20 Point Economic Programme were further stepped up during the year. Of the various activities undertaken by the bank during 1976 for increasing its involvement in the various points in the programme, the following may bear particular mention:

(*a*) Assistance to the allottees of surplus land was extended in various states. At Raidighi in the Sunderbans region of 24 Parganas district, West Bengal, 220 such persons were assisted for farm input procurement and development of small tank fisheries. In Assam, through five farming corporations, allottees of surplus land were granted assistance for land development and farm input procurement. Similar assistance was extended at Chas and Namkum in Bihar.

(*b*) Assistance to the allottees of house sites for undertaking such activities as goatery, piggery, dairy farming, duckery, weaving and small trade was extended at Haringhata in West Bengal and in Tripura. In Assam, a number of such persons were assisted to set up house dairy units at Saratpur, Jorhat. The scheme of assistance to the landless labourers was continued in Bihar and West Bengal. In Orissa, 270 such persons were extended Rs 1.87 lakh for setting up goatery units.

(*c*) As part of its assistance to the sharecroppers, the bank extended Rs 1.46 lakh to 180 sharecroppers in a cluster in the Sunderbans in West Bengal.

(*d*) In Bihar, small and marginal farmers were assisted to cultivate water chestnut in Darbhanga and to purchase draught animals and for land development in Chhota Nagpur area. In Midnapore district, West Bengal, Rs two lakh were extended to 200 marginal farmers for cultivation of water spinach.

(*e*) A composite programme for the development of the scheduled castes and scheduled tribes in 13 islands covering 21 *mouza*s in the Sunderbans was initiated. The bank also adopted the tribal village of Chaberia in this region. Assistance was extended for comprehensive development of these areas with special reference to development of agriculture and allied activities and cottage industries.

(*f*) During 1976, assistance for the development of irrigation was extended to a large number of accounts under various schemes including those for dug wells. The bank also participated in the minor irrigation projects of the state governments of Bihar, Orissa and West Bengal. Mention may also be made of finance extended to the marginal farmers in potato growing belts for sinking wells.

(*g*) The bank's involvement in the development of the handloom sector further increased during 1976. The amount of the banks' assistance to this sector rose from Rs 63.00 lakh in 1975 to Rs 97.27 lakh in 1976. The number of assisted weavers increased during the same period from 2,037 to 5,642. Some 25 different credit schemes to cater to the varied needs of the weavers, right from the stage of the procurement of raw materials to the stage of marketing finished products, were being implemented by the different branches in the east and the north-east. The experience of financing the handloom weavers revealed that the improvement of the economic conditions of these weavers was hindered by the existing system of raw materials procurement and marketing, which was dominated by the big traders. Therefore, UBI adopted an integrated approach to financing the weavers. They were organized on a cooperative basis so as to be able to procure yarn in adequate quantities at reasonable prices and to market their products at remunerative prices. With a view to assisting such cooperative societies in organizing weekly wholesale markets, three centres were identified and efforts were made to arrange warehousing facilities for them at these centres. At Barakar, the bank sanctioned Rs 1.38 lakh for the construction of 52 shops or godowns for the weavers' societies. At Midnapore, the West Bengal government agreed to lease out a plot of land for the construction of the wholesale market under the bank's scheme. At Durgapur, the Steel Plan authorities offered godown accomodation; the scheme for marketing assistance was estimated to benefit about 2,000 weavers of 30 different societies. At the same time, unemployed youths were being assisted to take up retail trading in products manufactured by the weavers under the banks' finance.

The bank's assistance under the different points of the 20 Point Programme at the end of 1976 was as mentioned in Table 5.10.

Table 5.10 Financing pattern under the 20 Point Programme

Sector	*Outstanding at the End of December 1976*	
	No. of Accounts	*Amount (Rs Lakh)*
Fair price shops, consumer cooperatives and superbazaars	12,740	533.68
Agricultural labourers or landless labourers allotted surplus land	8,158	41.61
Agricultural labourers or landless labourers allotted house sites for taking up productive activities	1,025	4.99
Clearing rural indebtedness or financing farmers and artisans for starting productive activities	1,95,597	1,203.00
Finance for minor irrigation	20,220	712.59
Weavers in handloom sector	5,642	97.27
Supply of standard cloth-assistance to distributors	430	17.01
Financing trucks under National Permit Scheme	87	84.45
Supply of essential commodities to students	87	2.38
Books and stationary at control prices	124	3.70
Total	2,44,110	2,700,68

Source: Compiled from the different Annual Directors' Reports, UBI.

Impact of the Development Finance by the Bank

By the mid-1980s, the bank had acquired considerable expertise in development banking. An important question here is; what was the impact of the deposit mobilization effort and liberal lending programme? For some sectors like small-scale, self-employed, transport, and so on, the results are quite visible. For example, the number of buses, taxis and autos financed by UBI in the eastern region is quite large. Small-scale industries financed are also numerous. For the north-eastern states, the number of bank offices and percentage to total in 1969 was 90 and 1.1, respectively. By 1972, the number of offices had more than doubled and the percentage share had also moved up to 1.55, thanks to extensive and intensive branching by UBI in the region. In the north-east, UBI has allowed small savers and fixed income groups to obtain fairly high savings rate and return on it. What is also clearly emerging is that the differential rate of interest and the partial relaxation of the binding credit constraints had a significant effect on the lending programme beneficiaries. Although a complete answer to the question of overall impact of the development banking operations of the bank is impossible without collecting detailed (panel and time series) data on the borrowers of the bank, it is instructive to go through the selective evaluative studies that the bank conducted.

For providing better irrigation facilities to the local farmers and for ensuring better utilization of their land, a group loan scheme of UBI has been in operation, since December 1972, in the six adopted villages of Lohardaga area in Ranchi district in Bihar. The villages adopted were Juria, Gamharya I, Torar, Srenghatu, Mundo I and Sinthio. For providing irrigation facilities to these villages, a river lift irrigation scheme has been launched by the bank and water tapped from the river Koel which flows near these villages is being tapped. The project envisaged provision of better irrigation facilities and better farm inputs as well as exposure of the group of participant farmers to mechanized farming. Since April 1974, new loans have been sanctioned to cover 20 new schemes in the area. The proposed coverage under the current year includes the village of Buti, Bakarni, Ghagra, and so on. With the initiation of the new schemes, the number of participants increased from 82 to 311, the command area increased from 154.58 acres to 589.58 acres, and the total amount of medium term loans sanctioned increased from Rs 1.44 lakh to Rs 5.42 lakh. Spectacular effects have been witnessed in agriculture as a result of these schemes. The multiple cropped area, as a percentage of the net sown area, worked out to 33.91 hectares in 1973–74 compared to 10.00 hectares in 1972–73. Multiple cropped area is highest in the case of small farms at 52.64 per cent, for large farms the proportion is 35.81 per cent, while for medium sized farms it is 21.61 per cent. The value of output also rose significantly. The value of output raised per acre for all strata worked out to Rs 741 in 1973–74 as opposed to Rs 296 in 1972–73. The value of output raised in small, medium and large firms stood at Rs 22,008, Rs 40,754 and Rs 68,122, respectively, during 1973–74, compared to Rs 11,153, Rs 27,399 and Rs 15,159 for the benchmark survey. However, the repayment of loans position has not been easy. The position of repayment of short-term loans from the bank (of 24 sampled participants) shows that 79.76 per cent of the short-term loans was outstanding as on April 15 1974. The unsatisfactory position regarding repayment of loans was on account of bad Rabi harvest in 1972–73 and poor Kharif crop in 1973.

However, the wheat crop in the 1973–74 Rabi season has been good and the farmers have started loan repayment after harvest. The bank also undertook studies to evaluate the progress of the different schemes of assistance in operation and the impact of lending to specific sectors and industries.

The evaluative study on the scheme at Baranberia in Nadia district shows that the multiple cropping index increased from 14.7 in 1970 to 25 in 1971 and further to 27.5 in 1972. The high yielding variety programme made considerable progress in the area. In the case of Rabi cultivation, pulses gave way to wheat, whose productivity was appreciably higher in the project area as compared to the non-project areas. Despite the problems of power shortage and drought in the pre-Kharif season, which affected the yield rate of paddy, there was an increase, albeit marginal, in the productivity of jute. The Kharif crop was, however, seriously damaged by flood. As a result, the farmers were not left with adequate surplus out of their farming operations and this affected, to a certain extent, their capacity to repay the bank loans.

A survey based on a sample of farmers financed by the bank during 1972–74 in the areas of Ranaghat, Panskura, Egra, Kalna and Champadanga in West Bengal, and Ranchi in Bihar reveals that there has been a rise in the money income of the borrower farmers. The increase in income was considerably high (39.2 per cent to 65.7 per cent) in four out of the six areas surveyed. The increase in income of the farmers has been primarily due to the rise in agricultural income. The rise in agricultural income, despite a steep rise in the cost of cultivation, was brought about by an increase in cropping intensity and higher crop productivity. Growing acceptance of improved practices by the farmers was noticeable particularly in Champadanga and Ranchi areas. Mechanized farming made considerable progress in most of these areas.

A study on the impact and operation of the bank's pioneering scheme of credit assistance to the small clay-modelling artisans was prepared in 1974. The study, which was based on a sample survey of the clay modellers at Kumartuli in north Calcutta, revealed that bank finance helped in improving the profit margin of their activity and their standard of living. The study also examined the nature and causes of unsatisfactory repayment performance of the clay-modellers in different years. In light of the recommendations made in the study, such as those relating to changes in time schedule for disbursement and repayment of loans, transfer of accounts to a branch in the vicinity of the clay modellers' workshops, expansion of the scope for lending, and so on, the relevant scheme has been suitably modified.

The bank came forward with a scheme for assistance to farmers in the drought affected areas of Bankura and Purlia in 1970. As soon as the districts were declared by the government as drought affected, the bank undertook a field survey to find out the feasibility of extending its assistance to farmers in the worst affected areas. Bagmundi and Arsha blocks in Purulia district and Indupur and Sonamukhi blocks in Bankura district were taken up under the drought relief scheme, under which lending assistance were provided to farmers for the masonry work for the *kachha* wells to be dug by farmers in the respective blocks in Purulia, while in the targeted blocks of the Bankura districts, the loans were made available for sinking shallow tube wells with coir filters and for the installation of pump sets. Maximum limits set for disbursement were as follows—(*a*) for masonry work for *kaccha* wells Rs 1,000 (*b*) for shallow tube wells Rs 1,000 and (*c*) for pump sets Rs 3,000. The scheme for assistance was operated from two of the branches of the bank—the Purulia branch and Sonamukhi branch. Officers were specially deputed by the bank to the drought affected areas to collect loan applications on the spot and to arrange expeditious disbursement through the branches. The scheme was implemented with the assistance of the state government agricultural department. These schemes enabled the farmers to raise two crops of paddy and potato and generated sufficient income for a reasonable standard of living as well as for at least partial repayment of the loans.

On the other hand, not all lending programmes were equally successful. The study on the impact of the banks' participation in the Marginal Farmers and Agricultural Labourers Development Agency's (MFALDA) Programme in Purulia district reveals that in each of the villages covered under the programme, only a small proportion of the marginal farmers were covered, since there was no systematic attempt at the identification of marginal farmers. The small number of loan accounts not only put up the cost of lending, but also made it difficult to impart proper supervision, which was of paramount importance for the success of any farm-financing scheme. It was not possible to prepare a farm plan for each selected farmer owing to the physical dispersion of the loanee farmers and inadequacy of the extension staff. Actual utilization of dug wells for irrigation and income generation therefore fell short of the target because of the lack of correlation among the command area and size of the well, size of the holdings, and so on. Many marginal farmers who did not combine the term loan for irrigation with the crop loan could not afford to undertake an improved package of farm practices. Smallness of the holdings was another factor responsible for the under-utilization of the command area of the dug wells. The subsidy provided by MFALDA being inadequate, the marginal farmers find it difficult to devote the whole of their time to the cultivation of their own lands during the busy season, when they work as hired labourers on others' lands. As a result, their own cultivation suffers. The study suggested a cluster approach to lending combined with the enhancement of the subsidy given by MFALDA and the formation of groups of two to three farmers when the individual holding is below the economic size, as the key to an improvement of the performance of the scheme.

Nationalization imposed many types of social responsibilities on the bank. Arranging finance for cold storage industry is an illuminating example. Not only did the bank have to maintain adequate financing for the effective stabilization of prices and smoothening of consumption, but also investigate whether there were distortionary economic effects of financing like hoarding and inflation and take remedial measures; in all this, the bank did a fine job.

Having noted the positive impact of the development banking programme of the bank, one must also point out the deficiencies. While the bank deposit mobilization programme was raising the incentive to generate long-term savings, the marginal rise in savings was coming at a high marginal cost, both in terms of labour and organizational effort. Normally a bank should have increasing returns in mobilizing deposits, but due to detrimental industrial relations and work culture that the bank faced, the marginal costs were high and increasing in most of the branches. Similarly, in terms of credit repayment, the bank had been unable to come up with an effective incentive structure, monitoring and enforcement. The moral hazard in the credit side of the portfolio was high and there was non-repayment even when there was good rainfall, irrigation facilities obtained through bank financing and bumper harvests. These operational inefficiencies were not only significant factors in the explanation of low profits in the past, but also harbingers of tough times to come as the cash flow and the non-performing assets situation got progressively worse.

Appendix 5.1 Evaluative Studies

Economic Effects of Cold Storage Finance by UBI

As discussed on page 195, myriad social duties were imposed on the bank by nationalization; arrangement of finance for the cold storage industry being one amongst many. The bank had to maintain adequate financing for effective stabilization of prices and consumption along with an analysis of distortionary economic effects, such as hoarding and inflation. Also remedial measures to the same were undertaken. In all this the bank did a fine job. We recount the story below.

The fast growth of cold storage units in West Bengal since Independence created a demand for finance to store perishable commodities, in particular potatoes. As the need for such finance rose, the banks were approached for granting refinance facility to the cold storages against the advances made by them to their renters against stocks stored. In 1964, UBI extended its credit line to the cold storage units for the first time. Since then, over the years, UBI advance to this industry has been steadily expanding. This credit expansion has contributed significantly to the expansion of cold storage units and potato cultivation in West Bengal. However, recent years have seen a rise in the price of potatoes and has caused a concern as to whether financing of the units by the banks is having an inflationary effect. Therefore, UBI instituted a study undertaken by the Economic Research Department to study the economic effects of bank finance. It had the following objectives:

(*a*) To study the effects of UBI finance to cold storage units, on the tendency of growers to hoard and profiteer, with particular reference to the potato crop.

(*b*) To study the effect of UBI finance to cold storage units on the tendency of the middlemen and cold storage owners to deprive the growers of the benefit of reasonable prices for their crops.

(*c*) To study the effect of UBI finance to cold storage units on the tendency of the middlemen and cold storage owners to raise the market price artificially to the detriment of the interests of the consumers, and suggest effective measures for ensuring stabilization of prices at reasonable levels.

(*a*) To study the effects of UBI finance to cold storage units on the tendency of growers to hoard and profit, with particular reference to the potato crop:

Small growers sell 50 per cent of their produce during harvesting; keep 20 per cent for seed requirements and store the remainder. This quantity is not large since they do not grow much and because of irregular cash requirement, they store it with themselves instead of the cold storage. Thus, cold storage financing cannot be said to increase their tendency to hoard and they have little capacity to hoard due to their irregular cash requirements over the short term.

However, the holding power of the relatively big growers has been increased as a result of the extension of bank finance. In fact, some of the big growers have also assumed the role of agents cum traders. They purchase potato from the small growers in the harvesting season and store it along with their own production at the cold storage while selling some at the local wholesale markets. As a result of bank finance, they are in a position to purchase a lot of potatoes and store at cold storage for the purpose of selling at higher prices. However, they also have cash needs spread over the year and since the repayment schedule of the bank finance requires that by September 50 per cent of the drawings are repaid, therefore they are unable to carry large stocks beyond October. However, if there is a deficit in potatoes due to crop failure in other states and low imports, then storage might result in hoarding for a few months. To conclude, the contribution of the relatively big growers who are not traders in potato towards hoarding and price rise appears to be very small. However, it is true that the availability of finance, whether from the banks or not, has increased their power of hoarding stocks for relatively longer periods.

(*b*) To study the effect of UBI finance to cold storage units on the tendency of the middlemen and cold storage owners to deprive the growers of the benefit of reasonable prices for their crops:

The middlemen who may be in a position to deprive the small growers of the benefit of reasonable prices for their crops include—(*i*) the traders who supply fertilizers and seeds, (*ii*) the big growers who are also traders cum agents of cold storage units, (*iii*) the non-grower local potato traders and (*iv*) the cold storage owners. It must be noted that with the setting up of the cold storages and quick dissemination of information among the growers, forced selling at unreasonably low prices by growers to the middlemen cannot generally occur. The number of middlemen being quite large, the dominance of any particular middleman over a small group of growers is currently not possible. As a result, the prices at which the growers sell from the beginning of the harvesting season are determined by competitive market forces of demand and supply. The prices in the harvesting season in recent years have not been below the average cost of production; rather prices are above 50–60 per cent of the average cost of production. In fact, this high profitability explains the fast expansion of acreage under potato as a cash crop by an increasing number of growers. Thus, the growers cannot be said to be deprived of reasonable prices for their crops due to bank financing. However, there are limits on the prices they can fetch, imposed by the cash constraints which prevent them for storing for peak price time and also the quantity that an average individual grower produces being small, he cannot afford to store the crop in the cold storage but can sell to the middlemen after storing with himself for sometime.

(*c*) To study the effect of UBI finance to cold storage units on the tendency of the middlemen and cold storage owners to raise the market price artificially, to the detriment of the interests of the consumers:

It must be noted that the scope for raising market prices artificially exists at two levels—(*i*) at the wholesale markets from where the retail dealers procure potato and (*ii*) at the retail shops from where the consumers buy. As far as UBI influence on retail shop prices is concerned, there is practically no effect at all. As far as the artificial rise in the wholesale price of potato is concerned, the role of middlemen and cold storage owners is under present circumstances rather limited. In the pre-1960 years, the cold storage owners used to fill the storages with their own purchased

> stocks of potato. They used to dictate the prices at which the *aratdar*s at markets like Aluposta had to sell to the retailers on a commission basis. The bargaining position of the cold storage owners in those days was relatively high because the *aratdar*s had to depend mainly on the supplies from the cold storage units during June–September and because the deficit in supply as compared to demand was much larger. Since then, however, both acreage and production of potato has increased and the number of cold storage units has also risen. At the same time, the *aratdar*s have become owners of a number of cold storage units and thus have considerably reduced their dependence on the non-*aratdar* cold storage owners for regular supplies.

The middlemen and the cold storage owners cannot—because of the usual uncertainties with respect to the supply of potato from outside and the behaviour of prices—artificially raise the prices through hoarding at the cold storages for long. Only the *aratdar*s cum cold storage owners have some advantage in this regard. These people control a substantial part of supplies whether from within the state or from outside, and possess information about prices and crop prospects throughout the country. Some of the bigger ones among the *aratdar*s also arrange to sell the potatoes coming from outside the state on a commission basis. Essentially, the degree of elasticity of demand by the retailers checks them from raising prices too much. However, the demand elasticity of the consumers being low, it is reflected in the elasticity of the demand at the wholesale level also. Thus, there is a clear incentive for hoarding. The degree of their price raising capability or arresting price fall is thus a function of the demand elasticity of the retailers and the proportion of stocks that *aratdar*s hold relative to the total supplies. They can increase their stock holding capacity by using the banks' refinance facility. In other words, they pay the renters the value of stock at market prices; less advances are paid without repaying the bank the loan it granted against the stock of potato at the cold storage. The larger an *aratdar* who owns a cold storage is, the larger the loan he can obtain and the greater the possibility of hoarding if there is a refinancing facility against holding of stocks offered by the bank on such a loan.

Recommendations

One of the economic objectives of cold storage financing by the bank is stabilization of potato prices. The sharp rise in prices in September–November was primarily due to the fact that production in the state is only 75 per cent of the total consumption needs and seed requirements. While it is true that middlemen, large growers and cold storage owners hoard and help the process of price rise to some extent, the retail traders are also responsible for the price rise during periods of scarcity. It is only the activities of the former against which the bank may be able to exercise some control. Again, given the uncertainties with respect to supply from outside and price behaviour, it is risky to compel the renters and the cold storage owners to follow any particular schedule for the release of stocks to the market. Neither is it legally possible to do so. However, the bank may consider revising the usual terms and conditions under which finance is granted to exercise indirect control over the tendency to hoard stocks. More hoarding of stocks is not so much responsible as is the concentration of stocks hoarded in the hands of a limited number of *aratdar*s or wholesale traders. Their ability to hoard depends on the finance available to them. The amount of finance provided by UBI is a small fraction of the total finance available to them. Thus, withholding of credit lines to cold storage owners will marginally affect the hoarding of potato in West Bengal. On the other hand, apart from affecting the income of the bank, it will adversely affect the UBI financed cold storage units.

However, the bank may try to ensure that the refinance facility granted to cold storage owners against the stock of renters does not help the cold storage owners to increase their own stocks. It should also be ensured that they do not help the stockist to withhold the release of stocks for unusually long periods. The instruments at the disposal of the bank to create indirect pressures on the cold storage owners include the ceiling prices, the margin stipulated, the rate of interest charged, the repayment schedule and the ratio of direct finance to growers to refinance facility granted to cold storage units.

It is suggested that the following changes be made in these parameters:

(*a*) The ratio of direct finance to growers to refinance facility of cold storage units should be raised increasingly. At the same time, it should be noted that the direct loans should be given to the small farmers up to a maximum of the value of 150 quintals, at ceiling prices with less margin per individual. It is desirable that the bank does not finance renters for stocking seed potatoes through the cold storage units.

(*b*) So far as the ceiling prices are concerned, it should be equal to the average wholesale prices at the Calcutta market during February of the concerned year, less transport costs.

(*c*) So far as the margin is concerned, while for the farmers the margin should be 25 per cent, for the cold storage units it would be 30 per cent. This would induce the farmers to take loans from the bank directly. Similarly, the rate of interest to be charged to the growers should be liberal.

(*d*) As far as the repayment schedule is concerned, the growers may be allowed part release of stocks up to a maximum of 30 per cent of the stocks stored. Before a grower is allowed part delivery, the grower would be required in each case to repay the bank an amount equal to the value of the 50 per cent of the stock released.

(*e*) The repayment schedule to be stipulated for the cold storage units against their refinance facility should also ensure that the bank advance is repaid as soon as the need for the finance of the borrower is over.

Also, it is suggested that the bank may explore the possibility of sponsoring and financing consumer cooperatives for retail sales of potato at selected markets on a pilot basis. The bank will control the prices charged by consumer cooperatives, so that consumer interests are served and cooperatives make decent profits.

Financing the Group Lift Irrigation Scheme in Lohardaga

For providing better irrigation facilities to the local farmers and for ensuring better utilization of their land, a group loan scheme of UBI has been in operation, since December 1972, in the six adopted villages of Lohardaga area in Ranchi district in Bihar. The villages adopted are Juria, Gamharya I, Torar, Srenghatu, Mundo I and Sinthio. For providing irrigation facilities to these villages, a river lift irrigation scheme has been launched by the bank and water tapped from the river Koel which flows near these villages is being tapped. The project envisaged provision of better irrigation facilities and better farm inputs as well as exposure of the group of participant farmers to mechanized farming. Since April 1974, new loans have been sanctioned to cover 20 new schemes in the area. The proposed coverage under the current year includes the village of Buti, Bakarni, Ghagra, and so on. With the initiation of the new schemes, the number of participants increased from 82 to 311, the command area increased from 154.58 acres to 589.58 and the total amount of medium term loans sanctioned increased from Rs 1.44 lakh to Rs 5.42 lakh.

Spectacular effects have been witnessed on agriculture as a result of these schemes. The multiple cropped area as a percentage of the net sown area worked out to 33.91 in 1973–74 compared to 10.00 in 1972–73. Multiple cropped area is highest in the case of small farms at 52.64 per cent, for large farms the proportion is 35.81 per cent, while for medium sized farms it is 21.61 per cent. The value of output also rose significantly. The value of output raised per acre for all strata worked out to Rs 741 in 1973–74 as opposed to rupees 296 in 1972–73. The value of output raised in small, medium and large firms stood at Rs 22,008, Rs 40,754 and Rs 68,122, respectively, during 1973–74 compared to Rs 11,153, Rs 27,399 and Rs 15,159 for the benchmark survey. However, the repayment of loans position has not been easy. The position of repayment of short-term loans from the bank (of 24 sampled participants) shows that 79.76 per cent of the short-term loans was outstanding due as on 15 April 1974. The unsatisfactory position regarding repayment of loans was on account of bad Rabi harvest in 1972–73 and poor Kharif crop in 1973. However, the wheat crop in 1973–74 Rabi season has been good and the farmers have started loan repayment after harvest.

The bank also undertook studies to evaluate the progress of the different schemes of assistance in operation and the impact of lending to specific sectors and industries. Major findings of some of the evaluative studies undertaken are as follows:

(*a*) River lift irrigation scheme at Lohardaga

The findings of the evaluative study on the group lift irrigation scheme at Lohardaga are quite encouraging. The multiple cropped area as a percentage of the net sown area of all size classes of farmers assisted increased from 10.0 in 1972–73 to 33.9 in 1973–74, the increase being the sharpest (from 16.5 to 52.6) in the case of small farmers having holdings below five acres. There was a substantial increase in productivity in respect of most of the crops, particularly Boro paddy. Primarily as a result of the increase in both cropping intensity and crop productivity, the annual value of output per acres for all strata of farmers rose from Rs 296 in 1972–73 to Rs 741 in 1973–74. The gross surplus per acre for all strata of farmers increased from Rs 227 to Rs 499 during the period. There was an increase in per capita income of the farmers also—it is estimated that for all the farmers taken together, the per capita annual income rose from Rs 195 to Rs 368, while for the small farmers it increased from Rs 137 to Rs 193. This improvement in the cropping intensity, productivity and standard of living was achieved notwithstanding the unusual delay in power connection by the Bihar State Electricity Board which seriously affected the wheat crop in 1972–73.

(*b*) Group loan scheme at Bolepur

The Bolepur project of financing farmers on group basis for minor irrigation started in 1972. The project made for an increasing utilization of land and brought about the desired change in the cropping pattern. The cropping intensity in the area increased from 1.17 in 1971–72 to 1.75 in 1972–73. The yield rates of different crops increased significantly during the period because of the adoption of improved package of practices along with the availability of water. Productivity of wheat and other Rabi crops, in particular, showed a marked rise. Income levels of the participant farmers registered a rise along with a moderate increase in the standard of living.

(*c*) Group loan scheme at Baranberia

The evaluative study on the scheme at Baranberia in Nadia district shows that the multiple cropping index increased from 14.7 in 1970 to 25 in 1971 and further to 27.5 in 1972. The high yielding variety programme made considerable progress in the area. In the case of Rabi cultivation, pulses gave way to wheat, whose productivity was appreciably higher in the project area as compared to the non-project areas. Despite the problems of power shortage and drought in the pre

Kharif season, which affected the yield rate of paddy, there was an increase, albeit marginal, in the productivity of jute. The Kharif crop was, however, seriously damaged by flood. As a result, the farmers were not left with adequate surplus out of their farming operations and this affected, to a certain extent, their capacity to repay the bank loans.

(*d*) Agricultural farming on an individual basis

The loans to farmers on individual basis, with which the bank began its farm financing activities, were also evaluated. A survey based on a sample of farmers financed by the bank during 1972–74 in the areas of Ranaghat, Panskura, Egra, Kalna and Champadanga in West Bengal and Ranchi in Bihar reveals that there has been a rise in the money income of the loanee farmers. The increase in income was considerably high (39.2 per cent to 65.7 per cent) in four out of the six areas surveyed. The increase in income of the farmers has been primarily due to the rise in agricultural income. The rise in agricultural income, despite a steep rise in the cost of cultivation, was brought about by an increase in cropping intensity and higher crop productivity. Growing acceptance of improved practices by the farmers was noticeable particularly in Champadanga and Ranchi areas. Mechanized farming made considerable progress in most of these areas.

(*e*) Participation in MFALDA programme

The study on the impact of the banks participation in the Marginal Farmers and Agricultural Labourers Development Agency's (MFALDA) Programme in Purulia district reveals that in each of the villages covered under the programme, only a small proportion of the marginal farmers were covered, since there was no systematic attempt at the identification of marginal farmers. The small number of loan accounts not only raise the cost of lending, but also made it difficult to impart proper supervision, which was of paramount importance for the success of any farm-financing scheme. It was not possible to prepare a farm plan for each selected farmer owing to the dispersion of the loanee farmers and inadequacy of the extension staff. Actual utilization of dug wells for irrigation and income generation therefore fell short of the target because of the lack of correlation among the command area and size of the well, size of the holdings, and so on. Many marginal farmers who did not combine the term loan for irrigation with the crop loan, could not afford to undertake improved package of farm practices. Smallness of the holdings was another factor responsible for the underutilization of the command area of the dug wells. The subsidy provided by MFALDA being inadequate, the marginal farmers find it difficult to devote the whole of their time to the cultivation of their own lands during the busy season, when they work as hired labourers on others lands. As a result, their own cultivation suffers. The study suggested a cluster approach to lending combined with the enhancement of the subsidy given by MFALDA and the formation of groups of two to three farmers when the individual holding is below the economic size, as the key to an improvement of the performance of the scheme.

(*f*) Assistance to clay-modellers

A study on the impact and operation of the banks' pioneering scheme of credit assistance to the small clay-modelling artisans was prepared in 1974. The study, which was based on a sample survey of the clay modellers at Kumartuli, in north Calcutta, revealed that bank finance helped in improving the profit margin of their activity and their standard of living. The study also examined the nature and causes of unsatisfactory repayment performance of the clay-modellers in different years. In light of the recommendations made in the study, such as those relating to changes in time schedule for disbursement and repayment of loans, transfer of accounts to a branch in the vicinity of the clay-modellers' workshop, expansion of the scope for lending, and so on, the relevant scheme has been suitably modified.

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6

THE CRISIS YEARS (1985–2000)

Like many other countries, the 1990s saw banking reforms initiated in India (brought about by the International Monetary Fund [IMF]-sanctioned structural adjustment programme) with the aim of bringing in deregulation, strengthening the public sector banks, and improving the efficiency and competitiveness of the banking system. This chapter begins with a review of the various banking reforms proposed and implemented. This provides the necessary backdrop for our critique of banking regulation and policy, and our evaluation of the performance of the bank. There was a general banking crisis in the sense that public sector banks were found to hold a huge quantum of non-performing assets (NPAs). On top of this, there were some bank specific features like excess branching, high fixed costs and low productivity. United Bank of India(UBI) was certainly a suffering bank on all these counts. The bank (along with some other public sector banks) faced a severe crisis in the early 1990s. We delve into some of the relevant statistics to obtain an insight regarding this phenomenon. In this context, we recollect and re-examine the controversial Verma Committee Report. Although the recommendations of the Verma Committee were not implemented, the report had a significant impact on the banking industry through indirectly shaping opinion on many issues. The new mindset in banking prompted a lot of management initiatives in banks and UBI was no exception. We review the recent management initiatives and their bearing on the performance of the bank. The chapter concludes with a brief analysis of the relationship between banking policy and banking crisis.

The Narasimham Committee Report

The motivation for financial sector reforms initially came from the publication of two important reports—the Chakravarty Committee Report,1985 and the Vaghul Committee Report,1987. The former was set up by the Reserve Bank of India (RBI), to undertake a review of the monetary system and suggest measures for improving the effectiveness of monetary policy while the latter was set up to study the means to improve the efficiency of the money market. The reports recommended significant deregulation and development of the short-term financial markets in India. Since the mid-1980s, RBI has implemented several of the key recommendations of the two committees in a phased manner. However, more broader and radical reforms encompassing the credit and capital markets had to wait till the adoption of the structural adjustment cum stabilization programme by the Indian Government in 1991.

The Narasimham Committee which was constituted to consider all relevant aspects of the structure, organization, functions and procedures of the financial system in India, submitted its report in November 1991. The Committee took a close look at the banking and financial system in India and made several suggestions and recommendations for improvement of the banking sector.

The main observations of the Committee were that despite the commendable progress made by the Indian banking and financial system in extending geographical spread and functional reach, serious problems did emerge resulting in a decline in productivity and efficiency, and erosion of profitability of the banking sector. The major factors identified were—(*a*) directed investment and (*b*) directed credit programmes. In both these cases, the effective rates of interest that were available to banks were less than the market rates. There had been a clear deterioration in the quality of the loan portfolio that was creating an impediment to banks' income generation, profitability and asset growth. Capital inadequacy has been accompanied by inadequacy of loan loss provisions. The accounting and disclosure practices were also criticized since they did not always reflect the true state of affairs of banks and financial institutions. The erosion of profits was also seen as a result of fast and massive expansion of branches that had no economic viability and many of which were unremunerative, especially in the rural areas. There had been a considerable degree of overmanning in the urban and metropolitan centres, and inadequate provisions in updating work technology. The Committee pointed out that both management weaknesses and trade union pressures had contributed to this. Also, weaknesses in the internal organizational structure of the banks were conspicuous and needed remedial measures. Both banks and development financial institutions had suffered from excessive administrative and political interference in individual credit decision-making and internal management. The deterioration in the financial health of the system has reached a point where unless remedial measures are taken soon, it could further erode the real value of return on savings entrusted to them, and have an adverse impact on depositor and investor confidence. Overall, the banking situation was considered alarming in all these respects and was perceived to have the potential for generating tremendous pressure on the fiscal and macroeconomic front.

Accordingly, remedial measures were suggested. These measures were pertaining to prudential regulation of cash and liquidity management, redefinition of priority sector, the reduction of directed credit, better asset classification and income recognition norms, and the setting of (asset-risk weighted) capital adequacy norms. There were recommendations pertaining to legal infrastructure for debt recovery and securitization of bank assets by setting up asset reconstruction funds. Further, there were recommendations pertaining to phased implementation of interest rate deregulation, deregulation pertaining to choice of organizational structure and human resource policy of banks, the desired market structure of the banking system and the optimal model of supervision of public sector banks.

Statutory Liquidity Ratio (SLR) instrument was recommended to be deployed in conformity with the original intention of regarding it as a prudential requirement and not be viewed as a major instrument for financing the public sector. Therefore, it was recommended that SLR should be brought down in a phased manner to 25 per cent, over a period of around five years. It was observed that the RBI should have the flexibility to operate the Cash Reserve Ratio (CRR) to serve its monetary policy objective. This recommendation of the Committee was not a controversial one, and was adopted and implemented without any significant resistance.

However, it was not to be so in the case of recommendations pertaining to directed credit programs. Though the Committee recognized the fact that priority sector lending had played a useful role in extending the reach of the banking system to cover sectors which were neglected hitherto, and there was clear evidence that the contribution of bank credit to the growth of agriculture and small-scale industry since the 1970s had made an impact, it was critical of unproductive lending that it generated and the implicit subsidy of such a programme that had been causing misallocation of resources. The Committee recommended a reevaluation of the directed credit programme and to make a distinction between beneficiaries who cannot do without the programme and those who are able to stand on their own feet and to whom the programme (with the element of interest concession) had become an economic rent. The recommendation was that the priority sector should be redefined to comprise the small and the marginal farmers, the small business and transport operators, village and cottage industries, rural artisans and other weaker sections. The credit target for this redefined priority sector should henceforth be fixed at 10 per cent of aggregate credit that would broadly be in line with credit flows to these sectors at present. It is interesting that the policy makers did not go along with this particular recommendation of the Committee, though there was an initial inclination to open the subject to national debate and feel the pulse of the nation. Another point worth mentioning is that policy makers failed to coordinate the social goals of banking with the fiscal policy. The question whether fiscal policy should at least partially substitute for the directed credit programme was not even debated in any significant way.

The Committee noted that the inadequacy of capital in the banking system was a cause for concern. The Bank for International Settlements (BIS) had implemented the Basle Accords in the western industrialized countries and the rest of the world was following suit. While progress towards BIS norms was felt to be desirable, it was felt that this was not achievable in one shot without endangering the credit conditions and therefore were to be phased over time. According to the Committee, banks and financial institutions should achieve a minimum of four per cent capital adequacy ratio in relation to the risk-weighted assets by March 1993. The BIS standard of eight per cent should be achieved over a period of three years. For banks with an international presence, it was necessary to reach those figures even earlier. In respect of those banks whose operations had been profitable and which enjoy a good reputation in the markets, the Committee suggested that they could straight away approach the capital markets for the enhancement of their capital. In respect of other banks, the prescription was that the government should meet the shortfall in the capital requirements by direct subscription to capital (by providing a loan that could be treated as subordinated debt). This recommendation was implemented by gradually raising the capital adequacy ratio to 8 per cent by the mid-1990s.[1] Before arriving at capital adequacy ratio for each bank, it was necessary that the assets of the bank be evaluated on the basis of realizable values (under the previous accounting system, the banks were booking interest earned on their balance sheets even without realization). The Committee strongly urged for a change of this scenario. The recommendation of the Committee was that the banks and financial institutions should adopt uniform accounting practices, particularly in regard to income recognition and providing against doubtful debts. The Committee also pointed out to the need for sound practices in regard to valuation of investments. For the purpose of provisioning, the recommendation was that assets should be classified as Standard, Sub Standard, Doubtful and Loss Assets. The recommendation was that the balance sheets of banks and financial institutions were to be made transparent and full disclosure made in the balance sheets as recommended by the International Accounting Standard Committee. The criteria recommended for NPAs was set at any asset on which there was non-repayment of interest over 180 days and more. It was also advocated that provisioning requirements should be given due recognition by the tax authorities.

The Committee suggested an arrangement according to which, at least part of the doubtful debts of the banks and financial institutions were to be taken off the balance sheet, so that they could recycle the funds (realized through this process) into more productive assets. For this purpose, an Asset Reconstruction Fund (ARF) was deemed necessary and it was recommended that it should be established within a short period. This fund could take over from the banks and financial institutions a portion of the bad and doubtful debts at a discount. The public sector banks and financial institutions should subscribe to the capital of the ARF. However, this mechanism of securitizing the bad debts of banks was fraught with the problem of moral hazard. If this easy way out was provided, banks could screen less and take more risks. Further, it would not be easy to operationalize the ARFs. If the fund were owned by a public sector entity then the problem would not be solved but merely shifted from one entity to another. If it were a profit maximizing private sector entity, it would need huge incentives for absorbing bad assets. Essentially, the NPA problem was systemic to the extent that existing legal infrastructure limited the enforcement of debt-repayment. Therefore, it was not surprising that the Committee felt the urgent need for a suitable mechanism through which the dues to credit institutions could be realized without delay. Special bank-debt recovery tribunals were to be set up to speed up the process of recovery. Due to the weakness of debt recovery tribunals and the existing legal framework of bankruptcy as embodied in Sick Industries Companies Act (SICA) and Bureau of Industrial and Financial Reconstruction (BIFR), there had been no solution to this extremely important problem. It should be noted, however, that legislation pertaining to recovery of dues to banks have taken place but without much significant impact, mainly due to ineffectiveness of the debt recovery tribunals.

Narasimham Committee had a very clear vision about the desired industry structure in banking. Regarding the structure of the banking system, a broad pattern should be evolved consisting of—(*a*) three or four large banks (including the State Bank of India) which could become international in character, (*b*) eight to 10 national banks with a network of branches throughout the country engaged in international banking, (*c*) local banks whose operations would generally be confined to a specific region, and (*d*) rural banks (including regional rural banks) whose operations would be confined to the rural areas and whose business would be predominantly engaged in financing of agriculture and allied activities. Also, branch licensing should be abolished. However, the Committee was silent on how the process should unfold that would result in this industry structure. Further, there was the question about mergers between banks; which banks were to be merged to become national and international players and which ones were to be converted into regional banks. The question whether healthy banks were to be merged with sick or troubled banks was also not clearly articulated and effectively bypassed. This was an important issue that needed discussion and debate and a clear policy approach—unfortunately, it was not to be so.

Another major recommendation of the Committee was that interest rates should be further deregulated so as to reflect emerging market conditions. At the same time, a reasonable amount of macroeconomic balance through a reduction in the fiscal deficit was deemed necessary for successful deregulation of interest rates. Premature moves to market determined rates could pose a danger of excessive bank lending at high nominal interest rates to borrowers of dubious credit worthiness. Concessional interest rates were to be phased out, according to the Committee. The basic objective behind this recommendation was that the structure of interest rates should bear a broad relationship to the bank rate that should be used as an anchor to signal the RBI's monetary policy stance. This gradually started an epoch of market-determined interest rates in banking which had a beneficial influence on the pricing of capital and risk.

Regarding organization structure and operations, the Committee felt that the internal organization of banks is best left to the judgment of the management of the individual banks, depending upon the size of the banks, their branch spread and range of functions. Further, there should be more autonomy enjoyed by the public sector banks regarding recruitment, training and choice exercised regarding filling up of top posts. It was emphasized that there has to be recognition on the part of the management and trade unions that the system cannot hope to be competitive internally and be in step with the wide-ranging innovations taking place abroad, without a radical change in work technology and culture, and greater flexibility in personnel policy. This important recommendation was partially implemented—banks were given some autonomy on closure of branches but were not allowed the same in their human resource (HR) policy. The latter meant that high value human resources continued to be drained away from public sector banks to the private sector.

With respect to the regulatory mechanism, the Committee observed that the Indian banking system had been over-regulated and over-administered. Supervision should be based on evolving prudential norms and regulations rather than excessive control over administrative and other aspects of banking organization. Greater emphasis was to be laid on internal audit and the internal inspection system of banks.

The inspection by the supervisory authorities had to be based essentially on internal audit and inspection reports. Their main concern had to be that audit and inspection machinery (which will cover the credit appraisal system and its observance) was adequate and conformed to well laid down norms. The opinion of the Committee was that the duality of control over the banking system between the RBI and the Banking Division of the Ministry of Finance, Government of India, had to end. The RBI had to be the primary agency for the regulation of the banking system.The Committee felt that the supervisory function over the banks and other financial institutions should be hived off to a separate authority to operate as a quasi-autonomous body under the aegis of the RBI, but which would be separate from the other central banking functions of the RBI. As long as the government has proprietary interest in banks and financial institutions, the Committee felt that it was appropriate for the Ministry of Finance not to engage in direct regulatory functions of these institutions. Unfortunately, excessive political and administrative interference by the government continued and the suggestions regarding the optimal model of supervision were ignored.

The essential difference caused by the Narasimham Committee report was thus in terms of income recognition and asset classification norms, capital adequacy requirements and the gradual deregulation of interest rates. This had an immediate impact on the (consolidated) performance of the public sector banks as Appendix 6.1 indicates.

From 1992–93 to 1995–96, public sector banks made losses on average and required big cumulative capital infusion by the government. The performance of the public sector banks as a whole was causing great concern to the government as well as the taxpayers and depositors. In 1995–1996, the Reserve Bank of India started the publication of NPA statistics. However, from 1996–97 to 1999–2000 the average net profit (after provisioning) of public sector banks (PSBs) started to show a positive trend. The NPA situation, however, remained alarming (see Table 6.1) and generated a big debate as to its possible resolution. The public sector banks were found to have around 10 per cent of their assets as NPAs in 1996–97. With increasing awareness, the banks started to tighten their credit and repayment policies leading to a reduction of net NPAs to around 7 per cent of net assets. For foreign banks, the problem was not significant while the private banks fell in between.

Table 6.1 Net NPAs or Net Advances of different categories of scheduled commercial banks

	1996–97	*1997–98*	*1998–99*	*1999–2000*
PSBs	9.18	8.15	8.13	7.42
Private Banks	5.37	5.26	7.41	5.56
Foreign Banks	1.92	2.25	2.94	2.37

Source: RBI website, www.rbi.org.in
Note: NPA—Non-performing Assets

However, the consolidated figures for the public sector banks do not reveal how vulnerable certain banks had become with respect to the problem. Viewed in this light, the UBI story is instructive.

The Crisis Faced by UBI

From 1985 to 1993, the UBI continued to grow as before in terms of deposits. However, with respect to other factors such as profits and advances, things stood in sharp contrast to earlier days.

Let us trace the beginnings of the period. In 1985, when K. D. Nayar became the chairman, his first task was to bring discipline. He subordinated other things like business growth to this task. He believed that when branches are not functioning properly and morale is low, consolidation is the key and not expansion. His single mindedness in this matter enabled him to improve the productivity of the staff, although it was said of him that he frightened the officer community in the name of discipline but did not take the same aggressive stance against the rank and file. Anyway, the growth of advances had slowed down during 1985–88 and things reversed when J. V. Shetty joined as the new Managing Director. During his time, the bank became the government's favourite for opening branches but it led to a situation of serious liquidity overexposure. Very soon came the Prudential Accounting Standards, which implied that the bank had to show significant losses due to provisioning for bad and doubtful debts, and the only viable strategy was to cut down on the lending front and let the losses be carried forward. Thus, the initial years of Prudential

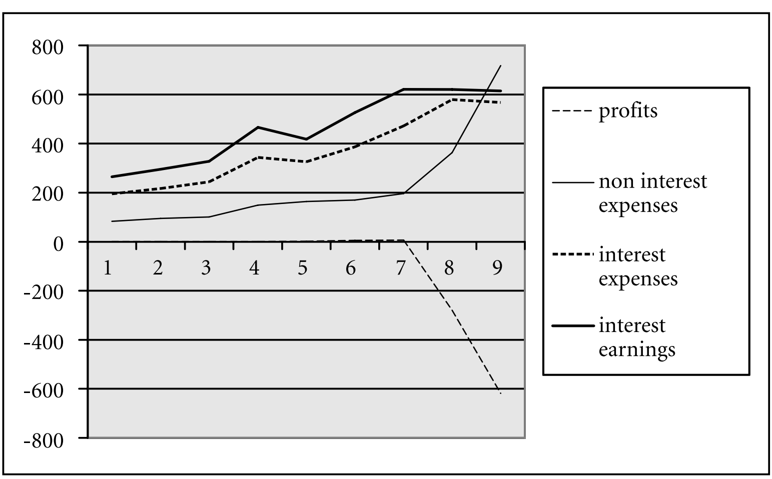
Accounting locked up funds for the purpose of provisioning and the bank's advances declined significantly.

Since the lending opportunities were getting squeezed out anyway due to the industrial stagnation in the state of West Bengal, decline in the growth phase was to a certain extent inevitable and cannot solely be attributed to the Prudential Accounting System (PAS).

Time period: 1985–1993

But PAS had a much deeper bearing on the bank's profitability. The bank had always struggled to generate positive profits given its predominantly social and development orientation and high overhead costs. On top of these, loan loss provisioning had a tremendous immediate impact on profits, and the bank showed big losses in 1993 and 1994. Even after that, losses carried forward to the end of this decade have been quite substantial. Another factor was that towards the early 1990s, the difference between interest earnings and interest expenses shrunk considerably (see Figure 6.1). This was due to the changing nature of the asset portfolio—more emphasis on safe but low return investments instead of risky loans. This, in turn, was caused by two factors—the credit embargo following the liquidity overexposure and a conscious decision by the top management not to

Figure 6.1 Earnings and expenses



Source: Compiled from the Annual Directors' Reports, UBI.

venture into risky territories before the NPA problem was sorted out, at least to some extent. A third important factor may have been the high SLR and forced subscriptions to low yield government bonds.

Table 6.2 shows a panel data on the profitability of the three weak banks in the 1990s. The UBI being one of them, it is useful for benchmarking the performance of the bank. It is clear that the UBI was most affected by the prudential accounting norms and saw huge losses in 1993 and 1994 after which the quantum of annual losses came down, but loss making persisted for three more years.

Table 6.2 Profitability of weak public sector banks (in Rs lakh)

	Indian Bank	*UCO Bank*	*United Bank of India*
1990	1607.73	0.00	114.65
1991	2100.47	0.00	577.61
1992	3650.32	–2098.68	667.90
1993	650.78	–44419.04	–27935.53
1994	–39064.59	–54645.15	–61805.67
1995	1426.11	–8381.06	–19723.24
1996	–133640.33	–23665.92	–23446.28
1997	–38909.00	–17623.23	–11363.86
1998	–30150.42	–9621.52	962.19
1999	–77849.73	–6776.77	1469.75
2000	–42697.03	3664.43	3136.01
2001	–27399.85	3299.65	1914.46

Source: www.rbi.org.in: Annual accounts data of scheduled commercial banks.

The second half of the 1990s saw positive profits though small in magnitude compared to the losses carried forward. In 1997–98 and 1998–99, there were positive profits for two successive years. However, this could hardly be termed as a monotonic and irreversible process of recovery, since there were significant fluctuations and operating profit dropped substantially in 1998–99. As the Working Group Report pointed out, operating income was increasing only because of the interest received on account of the income tax refund. Further, the positive profits turned to be illusory when one adjusted for the fact that income was mainly augmented by the interest income on recapitalization bonds. If that income was excluded, 1997–98 would show a loss of Rs 89 crore and 1998–99 would show an even greater loss of Rs 117 crore. In 1999–2000, there was a profit of Rs 31.36 crore.

Selective credit expansion to public enterprises started taking place in light of recent performance. However, since most of these were low risk clients, the interest charged Prime Term Lending Rate (PTLR, P-) was also low and thus earnings were not sufficiently high from these clients. In response to this situation, the bank decided to increase lending to the medium risk segment where returns are 15 per cent. This segment consists of products like housing loan, trading loan, service sector loan, and loans to hotels, restaurants and health resorts.

Overall, the lending situation did not improve much. In view of the predominant presence of the bank's network in the eastern and the north-eastern states, its progress had been greatly dependent on the economies of these states. The incidence of sickness of industrial units in West Bengal, and the prolonged economic backwardness of the north-eastern states with disturbed law and order situation made a serious impact on the bank's operations.

The high incidence of NPA was the most serious problem faced by the bank. The total volume of NPA stood at Rs 1,466 crore (estimated), comprising 30.8 per cent of the advances of the bank as at the end of March 1999. The repayment culture had not improved despite seeking intervention of concerned state governments. In most of the north-eastern states, the recovery percentage in the government sponsored programme was generally below 10 per cent and in certain areas it was as low as 3.5 per cent. Many advance accounts guaranteed by the Central and state governments turned into NPAs on which income could not be booked.

The bank was not been able to earn income for many years on a number of large accounts, which became blocked consequently upon nationalization of some of the sick units. The amount of such pre-take over dues, which could not yet be recovered, stood at Rs 80 crore (including cotton textile—Rs 11 crore, engineering—Rs 46 crore, paper—Rs 16 crore and coal—Rs 3 crore).

The disposal of cases under suit had been in general a long drawn process. Even the cases filed in the Debt Recovery Tribunal (DRT) were not disposed of expeditiously due to certain constraints. For example, the DRT in Calcutta was saddled with a large number of cases from all banks and financial institutions, and disposal of such cases by one presiding officer was getting delayed. In many cases, the verdict of the DRT was challenged through writ petitions and the recovery process through DRT was adversely affected. Of the 584 cases involving an amount of Rs 1,569 crore filed by the bank under DRT, only 84 cases involving Rs 162 crore were disposed off and the amount recovered for the bank stood at only Rs six crore at the end of December 1998.

The stoppage of fresh recruitment and embargo on branch expansion as a result of the adverse profitability position of the bank led to a high proportion of over aged employees and a dearth of new blood of young energetic personnel equipped with up-to-date knowledge and skill. Ban on recruitment, coupled with retirement of employees over the years, created a vacuum at senior and middle levels.

In view of these factors, the bank sought support from the Government of India or the RBI on the following items—(*a*) repayment in government guaranteed borrowal accounts or pre-takeover dues, (*b*) capital support, (*c*) merger or relocation of branches and (*d*) fund for implementing Voluntary Retirement Scheme (VRS).

The Verma Committee

A significant development in banking reforms during the 1990s was the setting up of the Working Group for restructuring weak public sector banks under the chairmanship of Shri M S Verma (a former Chairman of the SBI and an honorary adviser to the RBI) in 1999. The terms of reference of the Working Group included the following—(*a*) criteria for identifying weak public sector banks (PSBs), (*b*) to study and examine the problems of the weak banks, (*c*) to undertake a case-by-case examination of the weak banks and identify those which are potentially revivable and (*d*) to suggest a strategic plan of financial, operational and organizational restructuring of the weak public sector banks. Since UBI was identified as one of the weak PSBs by this report and it was seen to require restructuring on a priority basis, therefore, it is pertinent to revisit the report in some details.

The Working Group observed that the international experience during the last 30 years in over more than 100 countries saw periodic banking crises and attempts at restructuring of troubled banks. The basic principle observed in the restructuring process was that first a bank had to be restored to solvency and financial standards acceptable for prudential banking through financial restructuring be laid down. Next comes long term operational restructuring coupled with systemic restructuring. The international experience was that such restructuring exercises had to be comprehensive instead of piecemeal in order to be really successful.

A major observation with regard to public sector banks was that prior to the reforms, all but one (UCO bank) was reporting profits. In the second post-reform year, the profitability of the PSBs as a group turned negative with as many as 12 banks reporting losses. Also, eight banks were falling short of the minimum capital adequacy standards by March 1996, the deadline prescribed for attaining the prudential norms. In short, capital adequacy and the competitive deregulation were some standards for which the Indian PSBs were ill prepared. In particular, the vulnerability was marked in the case of three banks—Indian Bank, UCO Bank and UBI. According to the Working Group Report, 'they are trapped in a vicious cycle of declining capability to attract good business and increasing need for capital support'.

For the purpose of identifying weak banks, the Working Group used the following nine criteria (of which the first two were taken from the recommendations by the previous Committee on Banking Sector Reforms)—(*a*) accumulated assets and net NPAs exceeding the net worth of the bank, (*b*) operating profits net income on recapitalization bonds being negative for three successive years, (*c*) capital adequacy ratio, (*d*) coverage ratio, (*e*) return on assets, (*f*) net interest margin, (*g*) ratio of operating profits to average working funds, (*h*) ratio of cost to income and (*i*) ratio of staff cost to net interest income. In terms of these criteria, it was apparent that Indian Bank, UCO Bank and UBI were the weak banks.[2] The first of these could not meet any of the criteria, while the other two could only attain the minimum capital adequacy but that too with significant capital infusion.

Weaknesses were identified in three main areas—(*a*) operations, (*b*) human resources and (*c*) management.

The operational failures were deemed to be in high along with incremental generation of NPAs, slow decision-making with regard to sanction of advances together with compromise proposals and loss of fund based and fee income. The Working Group attributed declining share in key areas of operations as a major cause of the loss in fund based income and fee income. The problem was compounded, it was felt, by the limited product line and revenue stream, and absence of cost control and effective Management Information System (MIS) and costing exercise. Among other causes for weakness that were cited were weak internal control and housekeeping, poor risk management, insufficient customer acquisition due to mediocre service, low level of technology and non-competitive rates. These observations seem to be across the board and questionable—was it declining share or losses incurred in the key area of operations? Surely having a limited product line was to be less adapted to exploiting new market growth opportunities, but it was definitely a more focused strategy than having an abundance of product lines. Had the weak banks gone for a multiplicity of product lines that they were ill equipped to handle, they would have surely attracted criticism from the Working Group. Similarly, poor risk management and low technology are vague terms when the appropriate level of technology and context related risk management procedures are ill defined or not specified at all. It was also noted that operations of subsidiaries, foreign branches, the responsibilities of lead bank schemes and regional rural banking were causing a drain on the weak banks but clear alternatives were not spelt out in these spheres of operations. To sum up, the identification of causes for inefficiency in operations suffer from a clear benchmark and a thorough *what if* scenario analysis. At the same time, however, it cannot be denied that poor performance in the key areas of operations leading to loss of fund based and fee based income had become a major source of concern.

The Working Group Report cited overstaffing, low productivity and high employee age profile as the main HR related issues. Deployment of staff was flagged as an issue which was increasing the cost of overstaffing. Concern was raised about the low levels of skill and motivation of the work force. Skills in specialized areas such as foreign exchange, treasury management, and so on, were found unsuitable to generate sustained income from these operations. Training facilities were in general inadequate (UBI could be said to be an exception, having a devoted training institute though computer related training is filtering gradually even here). Morale and motivation was found to be at an extreme low. The report does not clearly spell out how a concept like morale was defined, measured and estimated, though casual empiricism does support the hypothesis. The fact that staff cost as a ratio of operating income was too high in the three weak banks was attributed to all these factors. It would have been useful if the report had related the question of nationalization with the increase in staff costs and all the attendant problems mentioned. Such an exercise was necessary in order to contextualize the problem within the sphere of banking history, union activism, and technological and manpower requirements of nationalized banking. But to some extent, this was outside the terms of the report and if one has to fill in the missing links at least partially, then one has to consider the report as a natural successor of the Narasimham Committee report. But basically the point remained that at least for some banks in the system, the labour intensive operational character of Indian banking had reached a satiation point and the institutionalization of the banking employees or the labour force had assumed such a proportion that it would be impossible to implement a change which could resolve the issue.

Under management related issues, the lack of successor planning, short tenure and frequent changes in top management and lack of support from the Board of Directors was cited. Lackadaisical implementation of earlier Supervisory Review Process (SRP) and Memorandum of Understanding (MOUs) was also mentioned in the report. It was emphasized that the basic weaknesses of management persisted despite the huge capital infusion of Rs 6,740 crore to these banks, over a period of seven years. It was mentioned that unconditional capital infusion had created a classic moral hazard problem—the banks anticipated being bailed out and refused to take costly actions. This is in fact one of many manifestations of moral hazard in banking due to bail out policies and deposit insurance by the regulators. Indian banking was found to have an incorrect regulatory mechanism at the top level of banking regulation, which just responded to exigencies without the consideration of future effect of policy, thus sending wrong signals and creating incorrect incentives in the process. But this is a long story and we shall return to this theme when we come to our conclusive discussion on policy.

The report noted that past efforts at restructuring had systematically avoided the hard options like reduction in staffing, hardening in retrenchment and wage negotiations, and so on. Plea for capital infusion was the best that the banks could do and after such infusion, only the desired level of capital adequacy was maintained. Otherwise, there was no improvement in income generation or cost cutting.

The Central Government decided to revive the three weak banks—Indian Bank, UCO Bank and UBI—through the measures suggested by the Verma Committee on restructuring weak banks. The government had infused about Rs 500 crore for VRS in the three weak banks in the budget of 2000–01. Another Rs 300 crore were made available through a soft loan from the World Bank for technological upgradation.

While it is hard to quantify the client base lost on account of customer dissatisfaction with the quality of the service, casual anecdotes and employee behaviour do indicate that such a loss might have been more than insignificant.

At the turn of the new century, the number of weak banks had increased from three to six, much to the unhappiness of the finance ministry and the banking regulator, RBI. The weak banks were Allahabad Bank, Punjab & Sind Bank, UCO Bank, Indian Bank, UBI and Dena Bank. The government decided that it had to have a close look at the operation of these banks and start them on a revival package. It was also kept in mind that while these revival packages or schemes were running, the respective bank's autonomy would need to be curtailed (*Hindu Business Line* 2001). The government held meetings with the six weak banks and also leading financial institutions such as IDBI, ICICI and IFCI, in August 2001, to carry out performance review (*Business Standard* 2001). Except Allahabad and Punjab & Sind Bank, the other four banks were classified as weak banks and it was decided that they be kept under continuous monitoring by the Ministry of Finance, Government of India and the RBI. The banks were also asked to come up with an action plan to revive their performance.

Appendix 6.1

Performance indicators of public sector banks from 1992–93 to 1999–2000 (each figure is shown as a percentage of net assets)

	Interest Income	*Interest Expense*	*Net Interest Income*	*Total Income*	*Operating Expenses*	*Gross Profit*	*Provisions*	*Net Profit*
1992–93	9.55	7.16	2.39	3.57	2.60	0.97	1.92	–0.95
1993–94	8.56	6.20	2.36	3.64	2.65	0.99	2.14	–1.15
1994–95	8.61	5.69	2.92	4.24	2.83	1.41	1.16	0.25
1995–96	9.20	6.12	3.08	4.48	2.99	1.49	1.56	–0.07
1996–97	9.69	6.53	3.16	4.48	2.88	1.60	1.04	0.56
1997–98	9.10	6.19	2.91	4.24	2.66	1.57	0.81	0.76
1998–99	9.01	6.21	2.80	4.02	2.66	1.37	0.95	0.42
1999–2000	8.92	6.22	2.70	3.98	2.52	1.46	0.89	0.57

Source: *Trends and Progress in Banking in India*, Reserve Bank of India, 1999–2000.

Notes

1. However, there are growing criticisms of high capital adequacy ratio in both the banking industry and academic circles. We shall visit those arguments later and provide our own analysis of the issue.
2. Earlier, the Confederation of Indian Industry (CII) on 16 December 1999 had asked the government to close down three 'weak' public sector banks—Indian Bank, UCO bank and United Bank of India, and privatize four others including the State Bank of India. Three days later, bowing down to the pressure from bank employee unions, the Confederation of Indian Industries (CII) on December 19 announced that it was withdrawing its recommendation to the Ministry of Finance to close down three weak banks. Further, the panel had also suggested a total overhaul of the Sick Industrial Companies Act (SICA) and the Board of Industrial and Financial Reconstruction (BIFR) too. For instance, a defaulting company should be referred to the BIFR if the management and secured creditors were unable to arrive at a settlement within 30 days. The BIFR in turn, will finalize the sale of the company within 120 days.

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7

THE RECOVERY AND BEYOND

From the data of the first two fiscal years of the new millennium, it appeared that the situation was changing for the better in Indian public sector banking. The United Bank of India (UBI) and UCO had achieved healthy and positive profit figures in these two fiscal years. The Indian Bank continued to make losses however and warranted further recapitalization. In March 2001, the Central Government charted out a recapitalization package for the Chennai-based Indian Bank, but the other two banks—UCO and UBI, were asked to restructure themselves by way of branch closures, layoff and other ways of cutting cost. The government said that during June 2002, there was no need to infuse fresh capital in the two of the three erstwhile weak banks—UBI and UCO —as they had turned around in the last fiscal year and the Finance Minister expressed satisfaction at the 132 per cent growth in profits of 19 public sector banks (*Financial Express* 2002). The UBI had posted a net profit growth of 579 per cent at Rs 119 crore (post tax) while UCO Bank had posted 400 per cent growth at Rs 165 crore.[1] Though the Finance Minister had congratulated the UBI on its performance and expressed great hopes about the prospects of the bank, the Ministry of Finance and the Reserve Bank of India (RBI) were going cautiously in their assessment of the bank—they wanted to wait and see whether the turnaround was part of a healthy recovery trend or just a temporary jump in profitability. Thus, they were not ready to immediately remove the 'weak bank' level from it. Normally, the process of removing a 'weak bank' stigma is painfully slow and the reputation of a bank matters a lot in the government as well as the RBI's approach to public sector banking regulation. For the UBI, the turnaround and *de facto* exit from the 'weak bank' status was fairly rapid. An enormous amount of effort was put in by the bank management to regain that confidence through new initiatives taken in strategy planning, organizational restructuring, internal control measures and the provision of performance based incentives to employees. Autonomy and confidence placed in the bank by the regulator significantly increased in 2002, when the Finance Minister openly congratulated the performance of the bank in an official speech. Finally, in 2005 the bank got back the full autonomy. The first section of this chapter gives an account of the turnaround and the recovery process.

Although, the turnaround of the bank and subsequent recovery can be attributed largely to the improved macroeconomic environment and high bond prices, the effort of the management in building upon and consolidating these gains cannot be underestimated. The second section of this chapter discusses the various management incentives that brought about the change. The crisis of the organization that had reached its peak in the mid-1990s had some positive externalities that turned out to be crucial for the turnaround and recovery of the bank. The bank management had realized the need for cooperation among all the sections of the employees in order to improve productivity and performance. Mr Biswajit Choudhury, as the Chairman and Managing Director, took special care in fostering an atmosphere of cooperation and amity among the employees. He largely succeeded in this task though initially he had to face some hurdles from certain sections of the unions. One advantage Mr Choudhury had was that he had been with the bank for a long time and he had climbed the public sector bank ladder from the grassroots. Thus, he had a decent understanding of the problems and prospects of the rank and file throughout the banking hierarchy. In his time, the bank was gradually moving from an environment of complacency and recurring losses, to one of decent profitability and farsightedness. It was Mr Choudhury's insistence of having a large investment portfolio consisting of government bonds that ultimately paid dividends in the form of high capital gains and interest income in 2002 and 2003. The successor to Mr Choudhury was Mr Madhukar who came over from State Bank of India (SBI), Bikaner. Mr Madhukar improved internal organization, and incentives and strategic focus of the bank in the retail segment. He also increased the accountability of management for performance and worked hard to bring a customer orientation among the employees. The efforts of these leaders were complemented by senior managers who reorganized their divisions through better planning, recovery officers who negotiated asset restructuring, senior managers who improved marketing, risk management and IT, branch managers who took the extra initiatives in making the retail products grow and numerous other employees who put in dedicated effort for the success of the organization. Though a lot remains to be achieved, especially in terms of providing incentives and motivating lower level and branch level employees, it must be admitted that the last few years have witnessed a culture change in the bank where accountability, customer orientation and cooperation are given high value across all sections of the organization. The growth of deposits and retail credit goes to prove that the customers and clients were placing a renewed confidence on the bank reflecting better customer relation management and cooperation from the bank employees. The improvement in staff productivity reflects further the cooperation across the rank and file and the provision of incentives for better management.

The crisis in Indian banking and the story of strong recovery by some of the public sector banks has captured the attention of theorists and policy makers in banking. The strong recovery made by UBI has merited special attention. Policy making in Indian banking stands at crossroads today—on one hand, the regulatory policy has to devise a strategy which improves the macroeconomic environment under which financial intermediaries operate, while, on the other, there needs to be a clearly articulated microeconomic strategy, which will remove the institutional bottlenecks in banking (particularly public sector banking) and improve the financial health of the banks. Policy debates regarding these issues are discussed in the last section of this chapter. The most important issue remains of non-performing assets (NPAs) in bank balance sheets. Although NPAs of Indian banks have come down as a proportion of total assets, the quantum of NPAs are still quite high. A closer look is taken at the pattern of origination of NPAs and the mode of reconverting them into performing assets. This naturally raises the second issue of optimal debt recovery and bankruptcy law. These institutions are still weak in India and need restructuring. Since adequate reforms of these institutions are not expected in the short run, recourse to measures like securitization has become an important alternative means of reducing bank NPAs. A welfare analysis aspect of securitization is made keeping in mind such important possibilities as moral hazard in monitoring incentives. An important issue that is addressed is that of desirability and optimal mode of bank bailouts through government recapitalization. It is shown that the mechanism of banking regulation and ownership and control of assets, together with the *ex ante* and *ex post* incentives, determine the optimal policy. The nature of the optimal policy for institutional strengthening in banking is also evaluated. The role of trade unions in recent times is discussed to shed light on the industrial relations and human resource (HR) constraints in banking. The section ends with a note on government ownership of banks and the nature of optimal reforms subject to democratic constraints.

The Recovery

The recovery from the lost decade of 1990s was as remarkable as the onset of the crisis in the early 1990s. The operating profit of the bank rose by 73 per cent to Rs 237 crore by March 2002. The improvement in the net profit position was significant—from Rs 19 crore in 2000–01 to Rs 119 crore in 2001–02. Further, this figure was achieved after the allocation of Rs 216 crore for gratuity and pension funds and full amount of leave encashment under the voluntary retirement scheme. It should be noted that earlier the Working Group Report criticized the lack of provisioning on these items. Therefore, it is a further evidence of at least a partial turnaround. Another piece of evidence is the reducing balance on accumulated loss. The bank reduced such loss by Rs 307 crore to Rs 1,240 crore.[2] What accounted for such a dramatic improvement? Basically, in the low interest–high asset price regime that prevailed during the year, the bank made a significant earning through sale of bonds, as a result of which income increased by Rs 229 crore. This was complemented by earnings on interest income which increased by Rs 104 crore. Out of Rs 22,776 crore of assets, Rs 11,656 crore were held in the form of investments and Rs 6,822 crore were held as advances. It is clear that treasury operations had become more important than credit management in terms of the impact on profitability and income generation. The recapitalization bonds were providing steady income. Had there not been a rise in operating expenses by Rs 217 crore, the performance would have been even better. In 2002–03, profits jumped further by around 200 per cent to Rs 305 crore from Rs 119 crore. The loss brought forward was reduced from Rs 1,240 crore to Rs 893 crore. Again, the increase came from the increase in interest income (Rs 85 crore), other income (Rs 35 crore) and a reduction in operating expenses from Rs 758 crore to Rs 591 crore. The bank management had not only turned the tide in favour of greater income generating potential, but also were successful in significantly reducing operating expenses. The last factor was even more creditable given the high costs of reducing staff and low productivity. The continued thrust on capital adequacy, asset quality and profitability brought about significant improvements in performance in the three years of the new millennium. Net NPA was 5.5 per cent in March 2003 (against a maximum set by RBI of 10 per cent). The Credit Rating and Asset Restructuring (CRAR) ratio was 15.17 per cent (against the RBI stipulated minimum of 9 per cent) and the return on assets was 1.37 per cent (against a minimum of 0.25 per cent set by the RBI).

During the year 2001–02, the bank management focused on improving efficiency, optimizing the utilization of available resources given the set of opportunities and generation of adequate surplus to absorb the deferred liabilities of yesteryear. With the enhancement of efficiency of available resources, including the capital already deployed in business, the need to seek for capital support from the government or mobilization of fund through Tier II component of the capital fund was obviated. Still the bank was able to implement its planned activities such as Voluntary Retirement Scheme (VRS) and Technology Upgradation Scheme. Replacement of costly deposit by less costly deposit reduced the overall cost of per capita deposit and resulted in qualitatively healthy growth of deposit. The advance portfolio was restructured so as to retain high yield on advance, despite the low interest rate regime and thus increase the net interest margin to a satisfactory level. Capital adequacy ratio also remained unaffected. The opportunity arising in the area of investment was exploited for supporting the bank's own resources and attending to the deferred expenditure of the last few years and ultimately for reducing the accumulated losses. Care was also taken to see that the bank's core cost should be supported by its core operation, that is, earning through interest and fee based income.

The year 2001–02 can be seen as a watershed in the history of the UBI. Not only was the bank able to shake off the 'weak bank' stigma but also it repositioned its business strategy to face the challenges of emerging competitive scenario. The bank launched a number of customer-friendly retail credit products with the vision of becoming an universal banking organization, providing the full range of financial services and products in a customer-centric fashion at the least cost and in an efficient, effective, responsive manner under the slogan and banner of 'Unique Banking Ideas'. Certain unique banking ideas were incorporated into these products or services to differentiate them from similar products of other banks that were in vogue in the market. For example, there were products for senior citizens, working couples, small families, and so on. Additional benefits were available for those availing of these financial services, such that relationship with the retail customers could be long lived and cultivated to improve the economic condition of the customer and the profitability of the bank. They were focused to appeal to the respective market segments and enhance the customer base. Unique Banking initiatives lifted the image of the bank substantially and the products launched by the bank formed their own niche segments in the market and enhanced the market share of the bank.

The bank was able to reduce the NPAs as proportion of total assets and total advances. Though there was a significant amount of debt restructuring, the recovery effort showed a significantly upward trend. This was a further indication that the improving financial health of the bank was not merely on paper, but reflected solid gains all round and especially in the organizational response to the problem areas indicated by past performance. The progress in the reduction of NPAs was also as dramatic as the increase in profitability. For the public sector banks (PSBs), NPA recovery through one-time settlement was showing satisfactory signs by the end of 2000 (*The Economic Times* 2000). The 27 public sector banks, including State Bank of India (SBI) and its associate banks, recovered a total of Rs 297 crore under the one-time settlement scheme brought out by the RBI dated 27 July 2000. The total NPAs with the public sector banks as on 30th September was Rs 53,294 crores, with a recovery of Rs 3,050 crore on the same date. The recovery was primarily in case of small loans in the range of Rs 1 crore to Rs 10 crore. The maximum recovery according to the new RBI guidelines, was made by Indian Bank, totalling Rs 98.6 crore, followed by Rs 44.5 crore by Punjab National Bank and Rs 31 crore by Oriental

Bank of Commerce. Unfortunately, the performance of UBI at that date was considerably below average as seen from the Table 7.1.

Table 7.1 Total NPA recovery as on 31 October 2000 based on revised RBI guidelines

	Number of a/c	*Amount in Rs Crore*
United Bank of India	5,713	3.0
All PSBs	129,199	297.0

Source: RBI Website, www.rbi.org.in

However, within the next three years there was substantive improvement. During the year 2000–01, the bank was able to bring down its net NPA to 10.5 per cent from 12.7 per cent. The bank recovered Rs 263 crore of NPA, out of which Rs 106 crore came through the one-time settlement scheme. In the first five months of 2002–03, the recovery of NPA during that period stood at Rs 65 crore. The bank's net NPA ratio registered a decline to 7.6 per cent in September 2002, against 10.2 per cent in September 2001. By December 2002, the UBI had issued notices to 140 wilful loan defaulters under the Securitization & Reconstruction of Financial Assets and Enforcement of Security Act (*Financial Express* 2002). The Chairman and Managing Director (CMD) of the bank stated that the bank had issued notices to 140 wilful defaulters involving a total default amount of Rs 75 crore. He stated that out of the 140 wilful defaulters who have been served with notices, 20 had already approached the bank for a compromise settlement. The chairman reported that the 140 defaulters who have been served with notices mainly belonged to the small and medium segment. Admitting that UBI was yet to serve notices to large defaulters, the chairman stated that the cases of most of such big defaulters was referred to the Board for Industrial & Financial Reconstruction and hence it was not possible for UBI to issue notices to them.

United Bank of India opened its Voluntary Retirement Scheme (VRS) for employees from 1 January 2001, targeting reduction of 10 per cent staff strength, bank CMD, Mr Biswajit Chowdhury stated on 24 December (*The Times of India* 2000). The VRS, which was spread over five years, was to cost an estimated Rs 200–300 crore for the bank

(*Financial Express* 2001). The UBI's total VRS cost worked out to be Rs 93 crore, but it was only a part of what was charged in 2000–01. With fantastic growth in profits in 2001–02, the bank cleared its entire obligation towards VRS benefits to 2,067 employees by encashing the five-year bonds issued in lieu of cash payment. The bonds offered an interest of 10 per cent a year. With this, the bank made sure that it would save on interest payment. The UBI, while issuing the bonds to the employees, had inserted a clause that enabled it to prepay the dues unlike other banks that are continuing to encash the bonds. Some banks had even opened fixed deposits on the 50 per cent of the VRS amount. Public sector banks were permitted to issue bonds amounting to 50 per cent of the VRS payment to employees, while the remaining half had to be paid in cash.

The strong recovery meant surplus cash, only a part of which could be used for lending. Thus, treasury operations and investments became even more important. The fact that the bank was making profits from them brought about a desire to tap the capital market. The UBI decided to enter the market with an initial public offer (IPO) in the year 2001–02 to part finance its needs on three accounts (*Business Standard* 2000). The bank would require nearly Rs 750 crore for raising its capital adequacy ratio (CAR), unveiling its VRS and for technological upgradations of its existing branches. The denial of the government to infuse fresh funds into the weak public sector bank before the end of the year 2001 forced the bank to borrow from the market to meet the RBI's capital adequacy ratio stipulation of more than 9 per cent. Post-bond issue, the bank's ratio stood at 10.44 per cent. According to the bank Chairman Mr Biswajit Choudhary, the bank wanted to raise around Rs 100 crore when market sentiment improved. Accordingly, UBI launched Tier-II bonds on 28 March 2001 to raise Rs 120 crore with a green shoe option of Rs 100 crore (*Business Standard* 2001). The unrated NCDs had a maturity of 63 months and carried a coupon of 11 per cent payable annually. By June 2001, it became evident that the bank had managed to raise just Rs 140 crore from the private placement of its five-year bonds against the targeted Rs 200 crore (*Business Standard* 2001). Soon the UBI was planning another round of fund mobilization through private placement. It was aiming to raise Rs 200 crore through this route. According to sources, the bonds were to be placed in the market some time towards the end of August 2001.

With a period of three years, the bonds were to bear around 11 per cent rate of interest for a period of five years. In 2002, the situation was very comfortable and in reply to a question, Mr Madhukar, the successor to Mr Choudhury, made it clear that there was no plan for an IPO immediately. The management indicated that the bank might consider it sometime in March or April 2003, depending on their exposure to various industries and the review of it by the RBI. However, the bank had clearly not made up its mind yet and on 15 June 2002, report came in that UBI was planning an IPO in January 2003.

By the early months of the fiscal year 2002–03, it was clear that UBI had made a strong recovery and given the market potential and future prospects of the bank, the process of recovery was deemed as irreversible. The turnaround of the bank was fastest in the banking sector and also one of the most remarkable in the entire corporate world. The bank did not need the government recapitalization support unlike the other weak banks. It posted remarkable growth in every yardstick, enabling the organization to reclaim a good image. As discussed before, the accumulated losses also came down with rapid pace. While presenting the budget in the Lok Sabha, the then Union Finance Minister announced that the bank had turned around and was making profits. He congratulated the bank on the excellent performance it had put in 2001–02. He emphasized that 'it could not have been possible without teamwork that right from the chairman, board to the last employee of the bank in the hinterland, everyone must have contributed to this excellent performance'. The Hon'ble Minister expressed his happiness and hoped that the excellent performance of the bank would be continued and it would move from strength to strength and the fact that UBI at one point of time had been deemed as a 'weak bank' would only be of historical interest and nothing more than that. He added that through this outstanding performance, the bank had recreated the confidence in itself and it was the confidence of the people, confidence of its existing clients, the confidence of potential clients and the confidence of people around its branches which would become the most precious assets of the bank in the years to come. He underscored the importance of the effort on the part of that bank to build on that confidence to enrich its asset base further. The Minister ended by saying that 'I am looking forward to a much better and more glorious performance from the United Bank of India.'

During the year 2002–03, the bank accelerated its attempts to improve efficiency through optimum use of available resources. Efforts were also taken to improve the size of its loan portfolio in such a way that growth takes place without warranting additional capital support from the government or mobilization of fund through Tier II component of the capital, which would have entailed high cost for the bank. The slant was towards churning of assets and improving the quality of balance sheet rather than merely increasing its size. The bank posted a net profit of Rs 305.19 crore in 2002–03, which was one of the best achievements in the banking industry. While the instance of fresh loan impairment had fallen two-third, the level of NPA at the end of the financial year 2002–03 reached the halfway mark of what it was just two years ago. The employee productivity of the bank jumped three times and became one of the best in the industry, despite being technologically far behind many other banks. This achievement was the result of continuous and sustained efforts undertaken by the bank in effectively managing the resources and proper deployment of funds, along with maintenance of internal controls and housekeeping. The bank also made sure that growth in social banking took place through carefully crafted and monitored priority sector financial products and services. The retail initiative of the last two years was kept up, as the bank realized that this was a key area for future growth and profitability in the light of growth of the middle class population. The upwardly mobile middle class with substantial purchasing power and desire to spend as per their changing lifestyles offered substantial market to the banks to improve their credit portfolio. To avail of this attractive opportunity, UBI started to cross sell its various retail products like credit card, debit card, insurance, and so on, apart from going all out to woo the customers with a combination of direct selling through bank branches and through technology banking, that is, Internet banking, phone banking, home banking, mobile banking and ATMs.

The bank registered all-round improvement in the working results in 2003–04 by further consolidating the progress achieved in the previous year. The bank focused on being customer driven, profit oriented and technologically advanced, continuously improving performance in all key areas. The bank went on for innovation, introduction of new products as also improvement of features of existing products to make them cost effective, customer friendly and easy to administer, thereby providing additional value to its customers. It made its foray into insurance business by tying up with Tata-AIG Life Insurance Company as its bank assurance partner. The continued thrust on capital adequacy, asset quality and profitability, resulted in the bank's position being well above the trigger points under Prompt Corrective (PCA) prescribed by the RBI. The marked improvement that UBI achieved with respect to the four criteria of autonomy package, that is, net profit, NPA ratio, capital adequacy ratio and net owned funds in 2002, together with performance at the end of March 2002, had helped the bank to restore its autonomy status. The greater autonomy was also extended to the bank by the Government of India in February 2005. The performance of the bank earned wide recognition of the national as well as the international agencies in their evaluation of performance of financial institutions in India. The UBI had been placed in the list of top 500 companies in India by Dun & Bradstreet, a renowned international credit rating agency, under three criteria—income, net profit and net worth. It acquired a high rating by both RBI and the market.

The bank's prime concern was to increase the volume of business in order to attain and sustain a critical mass, to face the onslaught of competition in the market and the challenges emanating owing to introduction of various prudential norms. It achieved overall improvements in the working results of 2004–05 by way of increasing the volume and the quality of business. Total business crossed the Rs 37,000 crore mark, surpassing the targeted level of Rs 36,000 crore. Credit Deposit Ratio (CDR) of the bank increased to 46.5 per cent in March 2005 from 27 per cent in the previous year. The bank management's continued efforts to increase retail credit raised its share in total credit to 15.2 per cent from 11.4 per cent in the previous year. The bank achieved 100 per cent branch computerization by the end of the year 2004–05. Advances to priority sector were around 37.4 per cent of net bank credit. The UBI made progress in implementation of the 12-Point directives of the government for doubling farm credit in three years. It achieved 83 per cent of its target under the directive of 30 per cent increase in farm credit over the fiscal year and attained 65 per cent in issuance of KCC. Against the target of bringing 8,47,000 new farmers into the bank's fold, 60,790 new farmers could be bought. The bank financed 577 new investment projects (involving an amount of Rs 17.12 crore) against a target of 2,100 new projects. Various relief measures were undertaken under debt restructuring. The bank focused on increasing its reach to potential markets and extending banking facilities to unbanked areas. With this objective in mind, the bank opened new branches and reallocated existing branches by way of merger, closure or relocation. After opening a branch at Sikkim, UBI obtained the permission from RBI to open another branch at Dhaka in Bangladesh.

According to the top management in the bank, at the end of the third fiscal year of the millennium, UBI aimed at increasing its business to Rs 50,000 crore by 2006 and wiping out the accumulated losses. It desired to become one of the best banks in India by way of qualitative and quantitative business development and growth in profits. Though the bank grew in profits in the last three years and substantially wiped out the accumulated losses of the past, the growth was not sufficient to completely wipe out the accumulated losses. The bank's balance sheet stood absolutely clean as on 31 March 2006 with the setting off of an accumulated loss of Rs 278.44 crore. The bank, after a gap of 14 years, paid a dividend of Rs 45.97 crore to the Central Government. To hasten the process of reducing accumulated losses, in 2006, the government had allowed the bank to wipe out accumulated losses so that the bank could approach the capital market and not forego profitable business opportunities (*The Telegraph* 2006). This technical write-off of accumulated losses till April 2005 has evoked a mixed response—some hail this as a long awaited move from the government that will go a long way to improve the performance of the bank; some others see this move as belated and of marginal significance because it came at a time when the bank had already brought accumulated losses to zero by the end of April 2006; and there is another residual group which does not follow the activities of the bank closely, to whom the news brings cause for concern and panic regarding the bank. While there remains enough subjectivity in the scope of forming opinions, perhaps the second view is closest to the truth—the bank was approaching the zero accumulated losses situation with certainty and the belated move by the government seems to be designed to wrest part of the credit from the bank management. It should also be noted that while the accumulated losses were set off against reserves, the current management feels that the reserves could have been protected had the losses been set off against the capital base since that would have forced the government to recapitalize the bank. The position of the current management is that the bank did not maximize the help that was warranted from the government in the crisis and post-crisis scenario. Looking at what other weak banks have done, one cannot but sympathize with this position. The bank has managed to tide over the crisis pretty much on its own and could have been in a stronger position with further recapitalization of the accumulated losses.

With high profits, reasonable capital adequacy ratio, low net NPA ratio and high rate of return on assets, the bank had not only successfully turned around but also become one of the top 500 Indian companies. It had acquired a high rating by both RBI as well as the market. The advertisement hoardings of the bank reflected the euphoria; the UBI was once again on its own feet and striding proudly. New products and new innovations were multiplying as the bank was entering hitherto unchartered areas in retail credit, merchant banking, development banking, risk management, and so on. A team of farsighted leaders and loyal managers were working hard on consolidating the gains made and trying to ensure that they would not be lagging behind in terms of competition, strategy, business process innovations, and so on.

Management Initiatives in Recent Times

The pre-crisis management at UBI was a creation of the exigencies of nationalization suitable for managing growth and expansion, particularly of the sectors targeted for priority lending. Routine administration across the hierarchical set-up was structured to maximize the growth of lending to these sectors, more often than not through branch network expansion. An important consequence of this was to relegate the important trio of strategy, risk management and business process innovations to the sidelines. More important than the quantum of neglect was the lack of awareness of the importance of these three issues. A lack of clear and well-targeted retail sector strategy stood in sharp contrast to the active role that foreign and private banks played in developing and realizing the potential of the retail market. Mismatch of assets and liabilities in terms of maturity and risk went unheeded, while the accumulating NPAs were neither recognized, nor measured and thus failed to give timely corrective signals. Innovations in business processes were also inelastic with respect to the demands generated by the changing environment and the power of information technology was not given full recognition. The recent initiatives have to be seen as correcting steps with regard to these issues and beyond.

Several developments in credit management took place during the reign of Mr Madhukar. In the foremost was retail credit—United Bank of India came up with schemes to woo banking couples (*Hindu Business Line* 2001). The bank provided incentives for married persons to approach the select retail boutiques of the bank for loans with wives. This was given in the following form—a husband–wife team together seeking personal loans from the boutique was offered a rebate to the tune of half-percentage point on the interest rate. The chairman of the bank conceded that his bank has been a late entrant in the area of retail loan boutiques, but it was the first to offer such attractive schemes for the husband–wife team. This was probably the first time that a bank was offering differential rates to retail clients, though most banks have been offering higher borrowing limits for couples. United Bank offered a similar package for personal loans, car loans and consumer loans. Under car loans, United Bank offered loans up to Rs 4 lakh, or 15 times the monthly net income of the borrower, whichever was less. It was Rs 6 lakh when the co-borrower was a housewife and 8 lakh when she was working. Similarly, the rate is brought down by 1 per cent to 14 per cent if the spouse joins in availing the car loan. The motive behind the scheme was to encourage joint borrowing so that risk is diversified and the benefit is passed on the borrower. United Bank also offered a similar relaxation on margin if the housing loan was availed with the spouse. While the bank stipulated a margin of 25 per cent for an individual, it came down to 20 per cent when jointly availed with the spouse and 15 per cent if she was employed somewhere. Besides, the repayment tenure was extended when the loan was taken with the wife. The bank stipulated that those up to an age of 35 years should repay in 12 years, but if the loan was taken along with the wife, the repayment period is extended up to 15 years and if she is a working wife, it is extended up to 20 years.

Recently, special importance has been given to marketing, risk management, NPAs management, information technology, publicity, communication and coordination. It has been recognized that improved communication fosters motivation and effort of the employees and helps resolve important disputes in industrial relations. Keeping this in mind, several measures have been taken. Apart from the bank's journal *United* and training college *News Bulletin*, a monthly journal *United Barta* is being published since July 2005. *Economic Briefs* on a daily basis, based on newspaper reports, is published and transmitted to all the executives at Head Office, regional heads and branches. Unprecedented in the history of the bank, a novel idea of direct interface with all the employees, by the chairman in the city of Kolkata and its suburbs, was translated into reality in the mammoth congregation at the Science City Auditorium and in the Town Hall, Calcutta, as also in Delhi at Sri Sai Auditorium. The bank had initiated a drive in the name and style of 'Know Your Bank' with an objective of generating awareness amongst all the categories of employees about various products of the bank. Business volume and operative areas being comparatively large, three regional offices, that is, North India Region, Western Region and Calcutta (South) Region were administratively upgraded to be headed by three General Managers and the office of general manager (Calcutta Metro) was abolished w.e.f. 7 December 2005. Marketing being the most vital function in an extremely competitive environment, the recent top management set about with a mission to introduce accountability and professionalism in marketing for the workforce. Lateral recruitment in UBI for specialized officers in Scale-III upwards started in July 2006.

Marketing received special attention from the top management in recent times. One of the various initiatives taken by the bank for deposit mobilization is 'Million Mission Programme'. The bank launched 'One Million Mission' in June 2005, in order to bring new quality customers in bank's fold and to mobilize the low cost deposit. The mission was accomplished in July 2006. This was a beginning and the bank is continuing with this programme and getting high results. Marketing being the most vital function in an extremely competitive environment, a new post of General Manager (Marketing and New Initiatives) was created to bring into sharp focus on marketing, publicity and new product development in retail sectors. To give a new fillip to the marketing movement in the bank, even the subordinate staff of the bank has been imparted training in marketing orientation programmes, besides, corporate workshops on marketing, participated by officers, staff and sub-staff. Extensive training course was initiated to impart on-the-job training to new officers in all the branches. Bank nominated senior executives to attend a course on Management Development Programmes conducted by Administrative Staff College of India (ASCI) at Hyderabad with the requirement of some difference from traditional approach. Two separate programmes on marketing were conducted by Indian Institute of Management (IIM) Calcutta, for marketing officers of the regions and selected branch managers. Expertise of IIM Calcutta, also imparted training to selected branch managers in Scale IV and above on 'Programme on Leadership Development and Marketing'.

Customer relationship was given importance as an integral part of the retail credit management strategy by Mr Madhukar and continued even after his departure. The United Bank Officers' Association, an affiliate of All India Bank Officers' Confederation, appointed a banking ombudsman to look into the grievances of the customers of the bank. Mr Niharendu Konar, a retired judge, agreed to act as the ombudsman. It was stated that the appointment of a separate ombudsman for the bank would not interfere with the operations of the banking ombudsman appointed for the State by the RBI. The management of United Bank also agreed to extend its co-operation to help the bank's ombudsman function properly. However, it must be noted that the bank only developed a passive approach to customer relationship management. Though incentives and rulers were implemented for the employees to respond to customer requirements, a more proactive approach, with an aggressive marketing and value creating orientation for the employees, as is customary practice with foreign banks, was not attempted. However, customer service quality had increased sufficiently for an impressive growth in deposits and retail credit.

The UBI launched credit cards in collaboration with SBI Cards while initiating 'anywhere, anytime' banking in Delhi and Calcutta (*Business Standard* 2003). The UBI launched three credit cards—UBI Gold Card, International Card and Advantage Card—which offered free AT&T calling card membership for making telephone calls while travelling overseas. The cards were launched in collaboration with SBI Cards & Payments Services. This was for the first time SBI Cards & Payments Services Pvt Ltd, which is SBI's credit card subsidiary, entered into co-branding with any bank outside the SBI family. This signal of confidence on the bank, by the largest player in the market, was an important event. CMD of United Bank of India stated that this trust reposed in United Bank of India by entering into co-branding arrangement only confirmed that United Bank was no longer taken to be a weak bank but one with newfound competitive niches. Mr Iqbal Singh, CEO of SBI Cards, stated that three types of credit cards would be issued by United Bank of India in 42 cities; six to start with. Mr T. K. Keshavamurthy, Chief General Manager of State Bank of India, Bengal Circle, stated that the co-branding arrangement only confirmed that the two banks need not fight with each other in the market place; it was possible to cooperate and still prosper, as there was room for everybody.

The bank launched several new products in corporate debt finance. One such product provided for incentive in terms of reduced interest rates or extended repayment period if a company practices prudent accounting and management policies. This scheme, christened United Performance Account, provided incentive points for continuous improved performance, timely filing of balance sheets, and so on, which will allow account holders to earn points on the basis of which they were to be able to get increased limit or reduced interest rates. Another development contemplated was a mortgage-linked financing product that will be disbursed on the basis of value of the property. The bank has also been offering lower interest rates to companies that are using agricultural products from the state as inputs and have a decent balance sheet. The bank also brought in further flexibility in credit policy by giving a standing instruction to all its branches to not cancel loan proposal for project if the loan amount asked for was too high. Instead, it was made mandatory to be directly passed on to the Head Office where it was to be decided, thus doing away with all the intermediary steps that generally delay loan disbursal.

Risk management was given high priority in the post crisis scenario, with large accumulated losses and high risk and maturity of the assets relative to the liquid liability base. Asset restructuring, limited exposure and diversification also became a new objective. The chairman of the bank made it clear that the bank was restructuring its asset portfolio, so as to ensure that the exposure to big accounts was halved from Rs 400 crore to Rs 200 crore and that the exposure to the middle segment as well as new sectors such as infrastructure and pharmaceuticals increased. Under Mr Madhukar, the bank set up the Asset Liability Management (ALM) System in conformity with the guidelines issued by RBI. An Asset Liability Management Committee (ALCO) was constituted and put under the Management Committee of the Board of Directors. Accordingly, the Asset Liability Management Policy was framed and implemented by the bank. The implementation of risk management in the areas of liquidity risk, interest rate risk and market risk were being coordinated through ALCO. The Credit Policy Committee was in charge of the supervision of credit risk management. For the bank, the lack of trained professionals and a lack of an appropriate Management Information System (MIS) for risk management were initially two significant obstacles. The bank responded to these operational difficulties by taking steps to improve its MIS and ensuring that the most efficient managers were placed in charge of risk management and that the top management got orientation in risk management through interaction with internal and RBI staff, who were equipped with the relevant procedures. The RBI played a big role in this as the initial knowledge, information and operational infrastructure for risk management operations were not there in the Indian banks. The RBI had also asked banks to transfer the maximum amount of gains realized on sale of securities to their Investment Fluctuation Reserve (IFR) of 2002. This was a reiteration of the caution voiced in the October 2001 Credit Policy which called for greater prudence in the matter, when it began to be clear that banks were putting more money in investments than credit. It was also becoming apparent that in view of falling interest rates, banks would make a killing on their investment portfolios. RBI's move was aimed at ensuring that banks did not fritter away these gains but used it to provide themselves a cushion against a possible reversal in the interest rate scenario. Banks were of course free to build up a higher percentage of reserves subject to their board's concurrence. UBI did not have an IFR in the beginning but with the growth of profits, it was gradually able to contribute towards the building up of its IFR. The Basle II Accord has been reached a few years ago with respect to operational risk management and India being a party to it, the Accord will be implemented in the country soon. In view of that, the bank management is developing the relevant capacity building exercise. This will involve identification, measurement, tracking and procedural mitigation of operational risks that the bank will encounter in its routine as well as strategic activities. In the meantime, the bank engaged in a restructuring exercise to better manage credit and risk. For giving a new thrust to recovery and for ensuring integrated risk management as well, General Manager (Asset Management) was re-designated as General Manager (Risk Management and Recovery). The portfolio of General Manager (Credit and Balance Sheet Management) was split and Balance Sheet Management was taken out, so that he may remain focused exclusively on Credit while he was re-designated as General Manager (Credit) w.e.f. 16 December 2005. With the additional responsibility of Balance Sheet Management, General Manager (Treasury Management) was re-designated as General Manager (Treasury, International Banking and Accounts) w.e.f. 16 December 2005. For exclusive monitoring of the Risk Management System, the Deputy General Manager (Risk Management and Recovery) was designated as the Deputy General Manager (Risk Management) w.e.f. 12 July 2006. The reallocation of responsibilities improved focus and accountability at the level of top management and also resulted in overall efficiency through improved delegation of authority and responsibility.

Geographic diversification became an important objective in recent times. While the bank will continue to hold its advantageous position of development banking, the top management with respect to the east and north-east management made it clear that it will open branches and increase operations in other parts of the country to achieve a better geographic diversification. In its bid to reach the furthest corner of the country, UBI opened its Aizawl branch on 21 August 2006, the first branch in the state of Mizoram. With the opening of this branch, UBI now has its presence in all the state capitals of all the north-eastern states. During 2005–06, the bank also opened its branches at Gangtok in Sikkim and at Itanagar in Arunachal Pradesh, both state capitals. The bank has a strong presence in eastern and north-eastern parts of the country. It has targeted to open 50 new branches all over India during 2006–07 for expanding its business. Most of these branches (94 per cent) will be opened in the potential areas of the states in northern, southern and western regions, to give the bank a national character. The bank has a plan to open 150 new branches in the next three years.

Another important issue was interest rate management. With deregulation of the interest rates, the interest rate structure became a new management policy tool. The policy focused on two objectives of reducing interest rates on deposits and raising the interest spread between the lending and deposit rate. The inelasticity of term deposits, the lack of low risk alternatives to term deposits contracts and the high unmet credit demand were seen as the right combination to achieve these goals. The UBI reduced the rates on deposits successively (senior citizens, however, were an exception and they received an increase in term deposit rates in 2001). United Bank of India on 31 December 2001 announced a downward revision of its interest rates for its domestic term deposits with effect from 1 January 2001. The bank announced a downward revision in rates of domestic term deposits by 25 to 50 basis points for various maturity periods, effective from 1 December 2002. This was the bank's second downward revision within a month. Earlier, it had reduced the interest rates on an average of 25 basis points w.e.f. 9 November 2002. The lending rates however, did not change much. The general trend has been a reduction in interest spread with liberalization and increased competition from other financial intermediaries and markets. The important thing to note is that the interest spread dropped for 20 of the nationalized banks in 2001–02. The UBI was among the seven banks for which the interest spread increased. In 2002–03, the spread went up for only three banks and UBI was one of them. How could UBI get away with increasing spread while others could not? Perhaps, one answer is that of UBI's position vis-à-vis the other major nationalized banks in Calcutta and West Bengal, and the private and foreign sector banks was such that UBI had a big captive depositor base that had high costs of switching to other banks. Given this, the demand for deposits was going to be inelastic and demand would not drop a lot, even if UBI successively brought down the interest rate. The strategy of successive reduction was also aimed at softening the perceived impact of the interest package change and worked in favour of the bank.

In business process, there were a significant number of innovations during the early years of nationalization all of which were labour intensive. Even in the non-priority sector lending, there was substantial labour intensity of operations due to high discretionary power that the decentralization of operations had brought about. On the liability side, the process of accounting for deposit inflows and withdrawals left a lot to be desired. As the branch network grew and irregularities in accounts multiplied, the Head Office started to lose the grip on the network and on the growth process in general. The emphasis on IT was belated and still not adequate for changing a complex and irrational asset portfolio bank to a risk adjusted flexible portfolio. However, a rational approach was tried to achieve a suitable mix of a labour intensive transactions process along with a high value-adding IT sector. The first challenge was to introduce modern technology in banking in order to retain competitiveness in today's dynamic world. In response to this, the process of computerization started in the 1980s. A Computer Department was established and minicomputers became operational at the zonal level, whereas advanced ledger posting machines were increasingly used by the branches in the latter half of the 1980s. A mainframe computer was installed in the Head Office in 1991 and operationalized in January 1992. In 1999–2000, the number of fully computerized branches had increased from 21 to 73 and the number of partially computerized branches increased from 115 to 225 during the year. More and more of the bank's business was being transacted through computerized systems. The bank was also moving towards providing full internal connectivity to all the metro branches through a hub and improving the systems architecture. Several new developments were taking place for banks on the IT front in the first three years of the millennium. For small and medium Indian banks, the outsourcing model for technology implementation was becoming one of the alternatives to the centralized ownership paradigm. The basic problem that the small banks were facing was of the absence of infrastructure to implement the technology in the retail and corporate banking sectors. Most of the banks are still in initial stages of computerization. But growing competition had forced these banks to increase their investments in the next few years. Some of these banks want to have a model with a mix of outsourcing and ownership (*Financial Express* 2002). The United Bank of India, with plans to invest around Rs 250 crore in IT in the next three years, showed interest in developing such a model. The UBI official stated that they would only outsource those part of applications where sharing of data was minimum. With the advent of modern technology, the ambit of the computerization department has been widened to cope up with the demand for extensive services and for a better administration; a new department under General Manager (IT) has been created on 7 December 2005 to spearhead such a movement. United Bank of India is one of those two or three banks who are yet to implement the CBS hitherto being identified and considered the last and must channel in banking operations. But since, substantial improvements have been made with selective strategies with appointment of suitable consultants and vendors. One such change is the Core Banking Solution or CBS. All branches are to be connected to the Head Office through a CBS, which will enable a customer having an account in a particular bank to get the same services at other branches. The bank is also implementing Cheque Truncation Solution for its branches under NCR of Delhi along with CBS. Implementation of the bank's own Virtual Private Network (VPN) has commenced. As many as 184 branches have already been brought under VPN. It is expected that out of 350 branches under Phase-1, 300 branches will be converted to VPN by end November and rest 50 branches by December end 2006. The bank initiated implementation of Internet Banking Solution provided by TCS through its connected branches, so that e-payment services for payment of excise duty and service tax could be offered to its customers, along with other normal Internet banking facilities. It is now ready for launching. For dispensing information on latest development in IT to all members of the United Family, an IT newsletter styled *United Technology* is being published monthly from July 2006.

The UBI was also an early entrant in joining the ATM network sharing. On 1 January 2003, the United Bank of India launched the *anywhere anytime* banking facility named 'United Tatkal Suvidha' by interconnecting its 19 branches and nine ATMs in Calcutta and Delhi (*Financial Express* 2003). Immediate facilities available under the scheme were cash withdrawals, cash deposit, transfer of fund, draft issue and mini statement of accounts. In March 2003, the UBI launched a unique multifaceted customer service called the United Mobile Banking, setting yet another milestone in its IT-related activities. The facility can be availed of from anywhere in the country or abroad with an appropriate mobile handset round the clock. It was formally launched by the Union Minister of State for Finance Anandrao V. Adsul. On 9 April 2003, UBI was one of the four state-owned banks to sign a memorandum of understanding to share their respective ATM networks. The other banks were—Bank of India, Indian Bank and Syndicate Bank. The move was to improve customer services and reduce transaction costs. Others followed their footsteps soon. The latest to enter are—Bank of Maharashtra, Dena Bank, Oriental Bank of Commerce, Punjab National Bank and Union Bank of India.

By 2002, the balance sheet and portfolio situation of the bank had changed a lot. There was surplus cash, big profits were coming from treasury operations in government securities and the idea of investing in other types of securities was increasingly becoming attractive. So it was not surprising that UBI management found itself toying with the idea of investing in the capital market. The management appeared to have taken an informal decision on this already and planned to commence operation with a small corpus of Rs five crore. Although several banks had been operating in the capital market, the UBI had so long stayed away from stock markets and dealt only in government securities and treasury bills. Bulk of the bank's profit last year was from the G-sec market. This was however true for most public sector banks. As much as 50 per cent of SBI's profit were from the G-sec sector.

Income from treasury operations through sale of investments (capital gains) was a major source of income in the first two years of the new millennium. The bank management gave due recognition to the fact that income from treasury operations and income from merchant banking were going to be a major source of income for the bank in the coming years. In order to augment non-interest income in the face of sharp decline in treasury income due to a sustained drop in bond prices in the later years, the bank took special measures. It launched a special campaign named 'Operation Kamdhenu' during the period July 2006 to December 2006. Merchant banking was also becoming more important. In 2001, UBI underwrote the issue of South Asia Petrochem along with seven other financial institutions (FIs). The company tied up foreign currency loans with Rs 250 crore from the leading FIs. It has also lined up Rs 69.5 crore fully convertible debentures issue, along with a Rs 5.0 crore equity, offering to fund its 1.4 lakh tonnes per annum project costing Rs 450 crore. There was also an opportunity for public sector banks to distribute insurance products. Life Insurance Corporation of India started negotiations with the UBI for marketing products in 2001. In 2002, the bank changed its mind and decided to postpone the alliance but the idea got underway finally in 2003. The bank, after closely observing the development of the insurance sector, tried to explore the possibility of bank assurance tie-up with progressive insurance partner, in order to fetch a non-fund fee based income without risk participation. Under this backdrop, the bank entered into life insurance business as corporate agent of Tata-AIG Life Insurance Company Limited and for Non-Life Insurance business with Bajaj Allianz General Insurance Company Limited. To compete with other players in the field of international banking, Western Union Money Transfer Scheme was launched and Proprietary Forex Trading was started. Signing of a Memorandum of Co-operation with EXIM Bank and the initiation of the preparation of operational desk guide on export, import, remittances and NRI deposits are worth mentioning in this regard.

In 1999, the Stock Holding Corporation of India Limited (SHCIL) tied up with United Bank of India to bring its 'Stock Direct Service' to the north-east. This service is a way of bringing together trading, fund and security transfers with SHCIL as the depository participant. It allows an investor, through a single instruction, to transact and settle his fund and security obligations. It was envisaged that such an electronic network would bring together the depository participants, banks and brokers. The Calcutta-based bank's strong presence in Assam through its branch network was seen as the main synergy factor that the service was going to leverage. SHCIL also mooted the idea of a co-branded credit card with UBI. Earlier, SHCIL had inaugurated a Request Transmitting Machine at one of UBI's branches in Calcutta and it was in this context that the possibility of a value added service like the card was explored. With the success in the north-east, Stock Holding Corp of India teamed up with United Bank of India to launch stock direct in Calcutta. The service was positioned as a one-stop shop that will allow investors to carry out securities-related transactions through request transmitting machines. The request transmitting machine was to be the first of its kind for Calcutta and was flagged off at one of UBI's best-located branches in the city.

Apart from continuing its traditional role in agriculture and small-scale industries, the bank explored new opportunities in development banking. Managing development banking in Jharkhand was one such possibility. The need for stepping up bank loans in Jharkhand state was emphasized by its Chief Minister Babulal Marandi, at a meeting with the managing directors of three Calcutta headquartered banks. Referring to the low credit deposit ratio in the state, which was as low as 27 per cent, the Chief Minister urged the bank chiefs to explore new areas for advancing loans. The Chief Minister estimated that about Rs 3,000 crore of additional deposits would be mobilized during the whole of 2001–02. However, the growth of advances left much to be desired. The total advances as on 31 December 2001 amounted to Rs 460 crore. The three managing directors of UCO, Allahabad and UBI, however, felt that one way to step up the credit–deposit ratio would be to encourage big industrialists to invest in the state. While the small borrowers would continue to get support from the banks, it was only the presence of big borrowers which would help the ratio improve significantly. Mr P. P. Sharma, Director of Industries, wanted to know if the banks would consider extending cooperation in case industrialists from outside the state could be persuaded to rehabilitate some of the closed and sick units within the state. The banks, it was pointed out, would have no problems in providing assistance provided the rehabilitation schemes were viable and the recovery was guaranteed. The three bank chiefs assured the Chief Minister that the government-sponsored schemes would continue to receive support. However, the proposals had to be credit worthy and the government must assure prompt repayment of loans. House building was one activity which, the Chief Minister felt, should receive due attention from the banks. It was stated that the banks too were eager to advance house-building loans, particularly in those cases where the size of each loan was not big, ranging from Rs 1.0 lakh to Rs 5.0 lakh. Financing of hotels in Ranchi was another area which the banks found worthwhile to explore.

High staff costs and low productivity had plagued UBI for a long time. Several initiatives were taken in cutting staff costs. One method was to introduce sabbatical schemes for the[3] staff. Most banks reduced their cost through such sabbatical schemes, combined with VRS. Initially, the UBI had problems in cutting costs and increasing productivity and the senior management of the bank started paying more attention to these issues. VRS off-take was slow but gradually rose during the second half of the 1990s and the management made sure that there were complementary steps for increasing productivity.

To give an example, at a function, the chairman felicitated about 12 employees, along with their wives—right from the regional manager to peon—for their excellent performance in 2001–02. The members of the board of the bank were also present on the occasion. This was for the first time such a function was held in the bank. From 2003–04, wives of a select lot of employees of the UBI were to receive awards from the bank management for the excellent work put in by their husbands. The awards were to be presented at a function to be held in a five-star hotel. The awards were open to all categories of UBI employees, from sub-staff to the regional manager. The bank devised its own means to judge the performance. The Managing Director of the bank, Mr Madhukar, first introduced the system of acknowledging the work of his employees a few years ago when he was the Managing Director of State Bank of Bikaner and Jaipur. The results were extremely good according to him and he felt that there was no reason why the same could not be repeated at UBI. The VRS was another way to cut overstaffing and high fixed costs (*Financial Express* 2001). Officers applying for the VRS at United Bank, UCO Bank and Indian Bank were subjected to scrutiny by a vigilance and audit committee, according to the directive by the Union Ministry of Finance (*Business Standard* 2001). The government provided assistance to three weak public sector banks—UCO Bank, United Bank of India and Indian Bank to enable them to pay arrears to their employees while offering voluntary retirement schemes, as it was learnt that the trade unions threatened to sue their respective bank managements if they announced VRS before clearing their employees' arrears. The scheme consisted of 60 days compensation for each year of service rendered or salary for the remaining years of service, whichever was less. Also, the compensation would consist of basic salary and dearness allowance. In line with the Cabinet decision on VRS package for PSUs, the committee suggested that employees who had put in a minimum of 10 years of service would be eligible to opt for VRS. Also, the minimum eligibility age was fixed at 40 years and anyone below that age limit would not be offered the package.

With a view to fostering better understanding among all the sections of employees and creating a greater degree of awareness among them regarding the vast changes that are taking place in the banking and financial environment, a Joint Consultative Committee was constituted in September 1992 under the chairmanship of the bank's Chairman and Managing Director. Besides the MD and the Executive Director, the Committee comprises, as members, senior executives of the bank and the representatives of the unions and associations of various categories of employees. The Committee has not been a forum for discussions of industrial relations or personnel management problems, but a forum for a change of ideas and issues, testing of ideas and perceptions on possible strategies and the introduction of new thoughts and ideas with an eye to formulation of strategies for the faster growth of the bank. A committee of such nature is a unique feature in the entire history of the bank and perhaps in the banking system. However, our interviews at the branch level reveal that percolation of new ideas and new mindsets to lower levels have yet to reach an effect whereby the highest degree of cooperation among the different stakeholders are achieved.

The UBI was also trying to regain part of its former glory as a thought leader in Indian banking. United Bank of India's Chairman and Managing Director Mr Madhukar showed that significant improvements in operational efficiency and productivity could be achieved if the bank management gave a whole-hearted effort. During his tenure, there were significant improvements in the manuals leading to more efficient business processes. Also, the strategic changes that were brought about had the required impact and focus. He also set off an important debate by stating that Indian banks should examine the relevance of maintaining capital adequacy ratio at a minimum of eight per cent, as specified by the Basle Accord (*Financial Express* 2002). He pointed out that most public sector banks that were recapitalized by the government were not been able to deploy the funds[4] gainfully and had to use them to maintain the mandatory ratios of credit reserve and liquidity. Being a successful turnaround manager[5] in Indian banking, Madhukar had a right to be heard and his thoughts were echoed in the industry circle, forcing the government and the RBI to pause and rethink about capital adequacy ratio. Mr Gupta, the next chairman, has also provided thought leadership by addressing the need of professionalism in banking services, pointing out the key role of marketing for banking growth and by questioning the running down of reserves and by pointing out the necessity of increasing capitalization through low cost methods.

Issues and Challenges for the Millennium

In his Budget speech of 2002, the then Finance Minister Yashwant Sinha said that the bank NPAs consisted of 13.19 per cent on loans between Rs 10 lakh to one crore. He also emphasized that NPA was negligible in case of large industrial houses and the percentage of NPAs to total advances has been consistently decreasing. The overall NPA in the priority sector lending of banks was 45 per cent, where the largest percentage was held by the small-scale sector. This representation was a vindication of the Narasimham Committee report that the main problem area was the priority sector and not big industrial loans. However, the banking policy did not respond to these facts—there was no willingness of the political and monetary authorities to reduce the burden of priority sector lending to banks. The policy of subsidizing the powerful large farmers and other rural clientele through opaque bank loans continued to be more convenient than direct fiscal transfers. While it was a fact that net NPAs were brought down significantly by the public sector banks, the quantum increase in NPAs has remained a source of worry. Further, sceptics point out that assets have been converted from non-performing to performing only through debt restructuring that involved refinancing and, as a result, the problem of asset recovery has not been reduced but only been postponed systematically in Indian banking. While this argument has merit and a significant amount of assets have been restored through refinancing, it is also true that better risk management and asset-liability management procedures have played important roles in alleviating the problem. The RBI had issued guidelines for detailed risk management, and asset and liability management for the banks in response to this, but this was a framework being set up within which the actual risk management by banks could vary significantly.

The consequences of the NPA problem were manifold. One implication was that corporates that had large investible funds refused to deposit their money with financial institutions who had large a large NPA base. Oil and Natural Gas Corporation (ONGC) was one example—UBI was one of the banks to be denied of a big ONGC corporate deposit (*Business Standard* 2002). Another implication was that the bank became shy in lending and started to ration credit to many borrowers. The good quality borrowers suffered as a result of the negative externality created by the bad quality borrowers (the classic Lemons Problem in the adverse selection literature). However, a positive side of the NPA problem was the focus on asset quality by the regulator, Ministry of Finance and the banks. Also, this has underscored the importance of other sources of income like income treasury operations, merchant banking, advisory services, and so on. Also, cost cutting operations in terms of interest and operating expenses were seen as a strategic device by banks facing adverse situations and burdened with low productivity. It was clear that mindset change had ushered in Indian banking through the impact of the NPAs.

After the new government came to power in 2004, the New Economic Policy was announced as one of 'reforms with a human face'. This implied higher spending on the social sectors, both through direct fiscal transfers as well as through the banking system. However, till date it has not been made clear how much additional burden it implies for the public sector banks. It will be unfortunate, if in the euphoria of economic boom and surge in banking profits, a reckless credit growth drive in the social sectors is prompted and the lessons of the 1990s are forgotten. As long as majority ownership of the public sector banks remains in the hands of the government, this danger will loom large. The government should not forget the three basic facts—the majority share of the NPAs have originated in the priority sector loans; the legal mechanism for debt recovery and bankruptcy settlement is still quite weak; and that although NPAs as a proportion of total bank advances have come down, the quantum of NPAs is a large figure that eats significantly into the surplus generated by the economic system.

The issue of voluntary or wilful default became important by the end of 1990s. According to RBI, the number of cases filed by banks and institutions against wilful default in 1999–2000 was 204, which increased to 711 in 2000–01 (*Business Standard* 2001). The Chief Vigilance Commissioner (CVC) Mr N Vittal, while addressing on the occasion of inauguration of UBI's wide area network on 15 February 2000, asked the RBI to make the names of wilful defaulters public in an effort to clean up the banking system and introduce transparency (*Indian Express* 2000). *The Economic Times* reported that the RBI expressed its inability to accede to his suggestion to publish a list of wilful defaulters on account of legal issues. Mr Vittal stated that he did not see any reason why the list could not be published. Mr Vittal stated that the CVC, in a similar move, had decided to put on its website the names of IAS and IPS officers against whom the CVC has recommended prosecution. He stated that he had corresponded with the RBI deputy governor, Mr S P Talwar, but the RBI stated that this might not be possible on account of Article 14 of the Constitution of India, the Banking Regulations Act and the RBI's banking manual. However, under pressure from all quarters that wilful default by corporates had become a significant part of the loan portfolio and that it was draining the banks considerably, the RBI came up with a published list of wilful defaulters. Further, it tightened the criteria of wilful default from 2002. Under the modified definition, a wilful default would occur if any of the following events occur in case of a borrower—(*a*) the unit has defaulted in meeting its payment or repayment obligations to the lender even when it has the capacity to repay the same obligations, (*b*) the unit has defaulted its payment or repayment obligations to the lender and has not utilized the borrowed funds for specific purposes for which the loan was granted; rather the funds have been diverted[6] for other purposes, (*c*) the unit has defaulted in meeting its payment or repayment obligations to the lender and has siphoned off [7] the funds and also the funds are not available in the form of other assets to the borrower. The writing-off of losses in the one time settlement scheme for non-performing assets announced by RBI during May 2001 was greeted with scepticism by banks. The banks perceived such a scheme as one of providing a safe haven for the wilful defaulters. Under the scheme, the 'no dues' certificate granted would enable such companies or promoters to get a substantial portion of outstanding interest written off by one bank, without preventing them from approaching other banks for fresh credit once again. Such habitual defaulters would only add to the large NPA figure.

Wilful default was not efficiently dealt with by the legal system which was plagued with delays and complexity. The creditors of Uniworth alleged that the company diverted funds and has wilfully defaulted on its working capital loan obligation to banks (*Business Standard* 2003). The UBI was one of the creditors reported to have suffered. The legal recourse with respect to protection of collateral was also suspect. The Supreme Court dismissed a special leave petition seeking a stay on the management's bid to sell its assets filed by the United Bank of India against the closed tyre maker Dunlop India (*Financial Express* 1999).

However, the Supreme Court ordered that Dunlop India was required to obtain the permission of the quasi-judicial Board for Industrial and Financial Reconstruction (BIFR) for selling any assets. Another issue regarding Dunlop was the timing of recovery of dues vis-à-vis the implementation of the BIFR ratified revival scheme. Commercial banks with a total claim of about Rs 70 crore on Dunlop India were vertically split on how to realize their dues from the ailing tyre company. According to information available, Dunlop's bankers, at an informal meet on 4 January, were sharply divided on the conditions earlier jointly put by UBI and SBI for accepting a BIFR-approved revival scheme. Banking industry sources stated that a section of banks led by UBI and SBI were determined not to accept any revival schemes, unless their dues were cleared at one go and the promoter was changed. Another section of banks led by Allahabad Bank wanted Dunlop to come out of the crisis first. They argued that the banks' main objective was to ensure normal operation in any business enterprise. These banks impressed upon SBI and UBI the need to hold meets with the Dunlop management for finalizing repayment modalities for their dues.[8]

It was not that there were not any answers to these problems, but only that the implementation of the solutions left a lot to be desired with respect to the speed of disposal. Legal developments like introduction of the Banking and Financial Sector Bill, 2002, concerning Asset Reconstruction Company (ARC), securitization and foreclosure laws accompanied the efforts of the government to tackle the NPA problem. The implementation of the Securitization Bill (SARESI) took a long time to come in to force and, by that time, a lot of damage had been done to banks through sale or diversion of assets pledged as collateral. The idea of an ARC held a great hope initially, but developments were slow and tardy. An ARC was supposed to buy NPAs from banks, securitize it and sell it to potential investors. It was proposed that the ARC would be a pilot project and would be formed by the investment made by profit making PSUs like Punjab National Bank as well as private entities like Kotak Mahindra, along with leading Financial Institutions like ICICI, HDFC, and so on. Also, there were efforts by the government to bring multilateral agencies like International Finance Corporation and Asian Development Bank to invest in distressed assets of the Indian banking sector and also create a separate market for securitized NPAs. But as the market price of an

NPA was likely to be less than the book value of such assets, the authorities needed to let the banks recognize the losses and reduce their recorded capital levels. Accordingly, a recapitalization strategy was worked out. The Ministry of Finance had also asked the RBI to come up with alternative methods to recapitalize weak banks in view of the capital's inability to set aside funds for infusion. But recapitalization was viewed as a last resort to strengthen the weak banks with capital adequacy ratio less than 8 per cent, since initially, the banks were asked to restructure themselves. The Reserve Bank of India, in its report on Trends and Progress of Banking in India 2000–01, stated that the new capital norms might demand a greater amount of capital for the banking system as a whole. The RBI had made a strong pitch against recapitalizing banks. It had noted that the global experience of bank recapitalization had demonstrated that the exercise of recapitalization did not necessarily prevent banks from getting into trouble again. This suggested that the banks would have to access the capital markets with a stronger balance sheet by transferring their NPAs to the ARC, to prop up their capital adequacy ratio by the year 2006.

Since the Narasimham Committee report, high capital adequacy ratio had been deemed good for Indian banking. Theory predicts a negative relation between risk and capital—too little capital creates moral hazard in the presence of limited liability; bankers tend to take more risks with deposits (other people's money). This has been the foundation on which the Basel Accords was built. In fact, the conventional story fails to fit the prudential banking and growth in the pre-nationalization era. Capital was low and the bank did indeed take systematic efforts to expand and grow. But returns were high. No undue risks were taken. The Basel Accord story fails to account for the recent past as well. The NPA problem eroded the capital base of the banking industry. It was not that capital got eroded first and then caused the NPA problem, nor that risky loans were sanctioned due to low capital–deposits ratio. It was not that lack of capital caused a lack of prudential monitoring and screening by bank managements. It was a systemic crisis compounded by unsustainable growth patterns in lending, staffing, branching, and so on. Legal infrastructure which deals with recovery of dues to banks, asset foreclosures and company bankruptcy, is more important than capital requirement in the medium to long run. Capital requirement is an *ex ante* device and not an *ex post* one. A forward-looking policy can prevent tomorrow's problems but cannot undo the past. Today's problems cannot be tackled by imposing capital requirements; the problems have their roots in the past and require different medicines. Essentially, the banks have to restructure their asset portfolios, renegotiate and recontract existing debt burden of the clients and recovery money by forcing bankruptcy in extreme cases. Here, the government was effective (though belatedly) by bringing about the Securitization Bill and by rationalizing the framework of corporate bankruptcy law. The new Securitization Bill allows collateral sale by the borrower to be prevented and asset foreclosure to take place on default without resorting to courts. It also provides a legal framework for setting up asset management companies and in the design of securitization of company assets under the new bankruptcy law, a single tribunal will replace BIFR with respect to company reorganization and the jurisdiction of High Courts in winding up. However, we have a long way to go in terms of securitization and bankruptcy law reform and just replacing BIFR with another tribunal or merging all matters under the tribunal are not going to take away all the substantive issues. The biggest challenge would undoubtedly be how to recover repayments from small-scale units and agriculture, when borrowers in these sectors have the capacity to pay but not the willingness to pay.

The government had a difficult job in the banking crisis—it had to protect a severe banking system meltdown, ensure fiscal discipline, satisfy the bank unions and prevent the depositors of the public sector banks from panicking. The availability of resources allowed bank recapitalization and due to the low interest regime that has been prevailing, treasury operations saw some of the banks like the UBI through trouble. To an extent, the situation was artificial because government was issuing the recapitalization bonds at zero price and paying a healthy rate of return to the banks and buying them at high prices. In the long term, this kind of fiscal policy cannot be sustained but it proved to be effective in the short run since the government had the resources and the interest rates were low. There was also an alleged moral hazard associated with this kind of bailout—the banks came to know that in a crisis the government would always be on their side. This would only increase further risk taking by banks, theorists would argue. While the argument has merit, one must also pay attention to the fact that the government and the RBI also directed the bank managements to focus on asset quality and reduction of NPAs. So the two policies of bailout through recapitalization and focus on asset quality enhancement ensured that the moral hazard argument was ruled out. Another factor was government ownership—government had a bigger role in the administration and management of the bank than just a regulator; thus the government's ability to improve asset quality of public sector banks was bigger than if it had tried to regulate management indirectly through incentives restructuring.

But most important of all, recapitalization was inevitable as there were no viable alternatives to it. Capital requirements following the Basle Accord's norms have been said to be a major feature of the liberalization in the financial sector. However, it is more of a conservative constraint on the banks rather than a liberalizing device. First of all, it forces the banks to raise capital at a high cost. Given the past performance of the nationalized banks, how is capital going to come to an ailing bank? The market will provide, if at all, at a very high cost and the government can only provide by borrowing or inflationary means. In that case, one problem will only replace another. A better alternative is to securitize the performing assets but the infrastructure for securitization is still not there in India. The obvious answer to this problem has been recapitalization by the government itself. However, the government stopped the recapitalization once it was clear that a bank could survive on its own and mobilize resources at a moderate cost from the market. The fact was that treasury operations saw UBI and UCO transiting from low to high profit zones, and it obviated the need for fresh capitalization of these banks. However, the accumulated losses posed a problem for the banks and the government, since these banks had to set a large amount of funds aside for the purpose of provisioning, when the opportunity cost of the funds in terms of foregone investment and lending opportunities were quite high. As mentioned before, in 2006 the government ultimately had to step in and wipe the accumulated losses of the bank.

In order to sustain the recent gains made in the market and to become competitive players in the future, Indian public sector banks need institutional strengthening measures. An ideal institutional strengthening package would be comprehensive and tailor-made to suit the specific requirements of a bank. Clarity has to brought about with regard to the goals of a banking organization and will require a carefully crafted mission and vision statement, together with measures that ensures that the bank lives up to its mission. Strategic planning capability has to be enhanced and strategy has to be designed keeping in view the core capabilities of a bank and the opportunities afforded by the market. The organization structure has to be designed in order to ensure the successful implementation of strategy. Going back to the case of UBI, the most important thing today is that UBI has a clearly articulated vision of the future and has been able to generate a mission statement to achieve that vision. There are some corporate values of critical importance like cooperation, motivation, customer orientation and focus. The top management of the bank has been endeavouring to ensure that these values are shared by all sections of the employees and relevant stakeholders. It is clear that in order to meet competition and counter uncertainty, a bank like UBI has to grow at a rapid pace while ensuring that asset quality improves along the path of growth. The relevant question is whether the growth should be organic or through mergers and acquisitions. For a bank like UBI which aspires to be a competitive national level bank, mergers and acquisitions seem to be the more preferred alternative. However, finding a right partner and implementing such a change can take a huge organizational effort. Recently, the Finance Minister made a statement that government would look favourably on bank mergers and indicated that some mergers between public sector banks were likely in the near future. This could have two different implications—one was that such mergers could exploit synergy and complementarities in different areas of operations and reduce fixed cost as a fraction of total costs. Thus, the banks would be more competitive in the future enabling them to tap the capital markets. A second view that seems equally likely is that mergers would create stronger public sector banks, which would be too big relative to optimal scale and governance capability, and that mergers could create conflict of cultures and motivations with a deleterious effect on productivity. It is a matter of time for mergers to occur in Indian public sector banking, but it is to be seen whether those mergers realize scale and scope economies and synergies or whether they confront incompatible corporate cultures to destroy value. In order to attain quantitative and qualitative growth in assets, a public sector bank needs more than just mergers and alliances. Developing strategic capabilities, efficient restructuring of organization and an improving Human Resource management policy are the three important tasks faced by these banks. UBI has taken an important step in strategy by assessing competitor strengths and weaknesses, and current and future market opportunities. This has enabled the bank to position its products in attractive retail market segments and develop specialized niche areas. However, this is only the beginning—the bank needs to develop a pro-active approach to finding opportunities under changing market conditions and constantly improve the range of financial services through timely financial innovations. The environment demands that banking management should be done in a pro-active manner unlike the passive approach of the past. Herein lies the future of public sector banks like UBI. As Chandler (1962) and Milgrom and Roberts (1992) have noted, structure follows strategy. Therefore, the organizational structure of a bank will reflect the strategic emphasis given to the core areas of operations. However, public sector banks have an organizational slackness on which they have to work upon; without that no efficient strategy can be meaningfully implemented. In order to efficiently restructure the organization, the management of a bank has to ensure that the allocations of delegated tasks are combined with appropriate incentives and authority. The business process revolution has revolutionized global banking and it is time that our banks took the advantage of this to improve organization design. Mapping of business processes should be accompanied by standard and environment specific innovations, Management Information System (MIS) will have to be built to communicate information and decisions quickly through the layers of the hierarchy, and divisions should be organized on a profit centre basis in order to provide better incentives. Decision-making processes have to be designed to improve coordination across different activities and across different units of the organization. The pressure from market investors and the regulators guarantee that these innovations will be adapted by the public sector banking organizations like UBI. The important question is how soon and with what efficiency these changes will be brought about. However, there remains another important factor without which organizational changes will not succeed in improving performance. Indeed, vision, mission, strategy and organization are hollow and meaningless concepts without a well articulated supporting HR management policy. It is widely recognized in management thinking that the employees of a firm are its most valuable resources. It is particularly true in the case of a bank which is a service sector and a knowledge based organization. A bank like the UBI will stand to gain much more from better recruitment, retention and promotion policies of its employees. Considerable autonomy is required in all this and the Ministry of Finance will do well to set the ball rolling by giving more independence to the public sector banks in these decisions. Without the ability to tap highly skilled and motivated employees from the market and without the ability to pay them competitive salaries, these banks will not be able to effectively compete with foreign and private sector banks. But how does a public sector bank implement the right HR policy in the face of powerful opposition from unions used to static inertia and opposed to change? How has the superior bargaining position of the unions affected incentives and contractual structure within the banks? Much has been said been about this issue but perhaps a few more words are in order.

Time and again we have seen the important role of the trade unions in banking—they would try to maximize welfare of the union member and address productivity, costs and management issues in banking. Historically, they have been associated with demand for higher wages and prompt payment of their dues. Typically, they have been seen to resist retrenchment, restructuring, branch rationalizations, and so on. The most important role they played was of course in wage negotiations and the enforcement of arrears. The weak banks developed the problem of wage arrears by the late 1990s and the unions of bank employees fought tooth and nail to ensure that there would not be any VRS payments before the issue of arrears were settled (*Hindu Business Line* 2001). 80,000 bank employees of three weak banks, namely, Indian Bank, United Bank and UCO Bank were involved in an agitation due to the non-payment arrears. While all the staff in the public sector banks got their wage revision and arrears by mid 2001, the employees of these three banks only got the wage revision and not the arrears, nor did the management discuss it with the unions as was decided earlier. The United Forum of Bank Unions decided to call off the proposed strike of 17 July 2001 as the management of the three banks had agreed to begin negotiations for payment of arrears in instalments from the fiscal 2001–2002 (*Financial Express* 2001). It was also agreed that the unions of these banks should discuss with their managements schemes for all-round growth and progress, and extend full cooperation for better performance of the banks. The three weak banks—India Bank, United Bank of India and UCO Bank implemented the bipartite wage settlement in July 2000, three months after the implementation of the pact in the industry. The last bipartite wage settlement expired in October 1997. The Indian Banks Association signed the wage pact with the bank union on 27 March 2000, months after signing the memorandum of understanding, paving the path for 12.25 per cent rise in wages of close to one million bank employees.

It cannot be denied that some of their activities increased the welfare of the average employee substantially and created an atmosphere of level playing field between the workers and the management. But their demands for higher wages were seldom tied to actual and promised increase in efficiency and productivity enhancements. Sometimes they were so stubborn so as to create a negative impact on the banking operations. The most important area where their neglect was gross was in customer satisfaction. It is well known that every year substantial amount of depositors switched their accounts from public sector banks where service was poor to private and foreign banks and which paid more than lip service to customer satisfaction. The UBI has not been an exception.

The difference of opinion with the unions surfaced in other important matters. The unions did not like the idea of a public sector bank moving towards universal banking (*Financial Express* 2003). The All India Bank Employees Association (AIBEA) was strongly opposing the public sector banks indulgence in the marketing of insurance products of private insurance companies. The PSU banks selling private sector insurance policies run with risk, said AIBEA General Secretary Mr Tarakeswar Chakraverty. He stated that they would land up in serious trouble when the private companies close down. He admitted that much thought had not been given to this issue and said that AIBEA would take a decision at its two-day Guwahati meeting from 5–6 June 2003. Satisfied with the performance of the PSU banks during the fiscal 2002–03, Mr Chakraverty stated that all the banks posted profits. The performance of United Bank, UCO Bank and Indian Bank has proved the Confederation of Indian Industry (CII) study wrong. Stating that the major portion of profits came from portfolio management, he cautioned that this profit would be there when the government swaps the high yielding government securities with low yielding securities. With private borrowers either having enough money at their disposal or borrowing from mutual funds and non-banking financial companies, the bank credit take off has not been encouraging. Though the private banks have performed well, they are not in a satisfactory position, he stated. Mr Chakraverty also expressed concerns over undiminishing non-performing assets—total NPAs in percentage terms may not have gone up, but there was a quantum wise increase during the year. He stated that the Securitization Act has been of little help in reducing the NPAs and suggested further amendments for greater effectiveness. His recommendations included provisions for attachment of personal properties of the promoters, guarantor, and their kith and kin, a provision that banks recover their loans in a specified time and exemplary penal action, including imprisonment and disenfranchisement, be initiated to deter wilful defaulters. Essentially, AIBEA was arguing for a better legal machinery for recovery of loans through tribunals and fair bankruptcy proceedings. This underscored the point that unions have generally taken—there was a negative externality generated through wilful defaults on bank restructuring that was threatening to punish the employees instead of the defaulters. To the extent that wilful default has been empirically important and the extent to which the bank employees could be made to suffer due to this, the point was legitimate. However, it remained a fact that wilful default by large industrial houses were a miniscule fraction of the total NPAs. Most of the NPAs came from the priority sector lending and advances to small borrowers. As far as bank employees suffering in terms of wage freezes, slow payment of arrears, low promotions, VRS, and so on, were concerned, the basic contractual structure governing labour relations in banking has to be revisited. Public sector banks provided the bank employees with job security and steady income growth along with the right to participate in various matters of management and governance. All these facilities were hitherto tied neither to productivity nor to the financial position of the bank concerned. In the wake of the financial crisis, there arose a demand by the banks to share part of their risks together with the employees. This was fair especially as the bad times were transitory—there was not going to be much of an impact on the permanent income or wealth of the average bank employee. In addition, one might say that employees ought to have a moral obligation to share risks with the bank which has given them job security and income growth assurance.

The advocates of public sector banking say that there are three strong justifications why government should own these organizations—first, the government needs captive source of funds for redistribution and investment; second, social welfare is higher if promoted through subsidized priority sector lending rather than direct subsidies and; third, employees need protection of tenure which can be only forthcoming through public ownership. Till government builds enough fiscal prudence, till subsidies become of marginal importance and till the labour force in such organizations have equal or better alternatives outside, the proponents hold that there remains no viable organization alternative which dominates government ownership of banks in terms of economic and social welfare. This argument is misleading to say the least. As long as there remains Statutory Liquidity Ratio (SLR), the government can always borrow from the banks. Even without SLR, the banks would have a significant amount of assets as government securities instead of parking all of their funds in risky assets like loans and private sector securities. Admittedly, without the full control that ownership entails, the government will not be able to borrow as much as they want from the banking sector and will have to take recourse to costly market finance. But it is precisely this kind of disciplining device that is required for the government to build fiscal prudence in its governance and administration. The arguments of subsidy requirement and that subsidized bank loans are better than direct fiscal transfers have some merit. Surely, weaker sections of the population have to be subsidized and surely loans entail better performance incentives than direct subsidies, which people take for granted and make it an excuse for under-effort for whatever one is doing. However, the issue is more subtle than that. The crux of the matter is that subsidy should be transparent, which is not what bank loans are, and therefore they are susceptible to political use. Large farmers, who earn at least as much as the median households in the middle class population, take a significant chunk of the priority sector loans, leaving only 25 per cent for the small and marginal farmers and small-scale industry. Further, subsides are a function of necessity as well as political lobbying.

Therefore, subsidized credit does not always go to the targeted beneficiaries if they have weak lobbying power. To sum up the subsidy issue, priority sector lending should be transparent, sensitive to needs of beneficiaries and gradually reduced for those who can do without it. Moreover, all this can be done without state ownership in banking and political use of valuable financial assets of the nation. Simply observing that tenure does not go well with HR reforms and improving employee productivity may counter the third and final argument regarding the need of tenure of the bank employees. Private sector banks have been historically seen as more efficient than their public sector counterparts throughout the world. R. LaPorta et al. (2000) demonstrate that such government ownership of banks is associated with slower financial development and low rates of growth. Controlling macroeconomic crises (though in some countries risky private sector bank lending caused such crises) and improvements in productivity are visible in all banks across the globe that have privatized in the last two decades and the productivity improvement in the case of the Indian counterparts can more than compensate the employees for lack of tenure through higher pay and perks. Having said all this, one cannot foresee a major change of ownership in Indian public sector banks. Despite weaknesses in several areas like risk management, strategy, HR, and so on, it has to be admitted that the performance of the Indian public sector banks today, in terms of return on assets, is one of the best in the world. Further, the banking system, though with considerable help from the government, has shown a resilience in the face of crisis that banks in other liberalizing and emerging economies have not been able to emulate. Thus, the political economy of public sector ownership makes the current arrangement stable and warrant that the politically acceptable policy measures have to rely on changes which are incremental in nature.[9] The necessary change in the short run is that cross subsidization entailed in priority sector lending and other activities should be transparently accounted for and gradually reduced to improve the incentive structure within the PSBs. In the long run, the ownership structures have to move to one where the optimization of the operational efficiency and the minimization cost of capital by the bank management are ensured through the significant ownership of bank assets by market investors, and the social and macroeconomic aspects are taken care of through residual ownership by the government and the regulator. As we write the last chapter of the history of the bank, some banks are already beginning to approach the capital market. With increased professionalism of banking habits and services in the bank, the first chapter of the future of UBI could be about a combination of raising low cost capital from the market, unprecedented asset growth in high return–low risk segments, improved risk management and strategic focus on key areas.

NOTES

1. All the 19 nationalized banks in 2001–2002 posted 132 per cent growth in net profit. In absolute terms, Canara Bank outsmarted others with a net profit of rupees 741 crore, followed by Punjab National Bank, BOB and Bank of India. Oriental Bank of Commerce with a net profit of rupees 321 crore, Union Bank of India with rupees 314 crore, Corporation Bank, Syndicate Bank, Indian Overseas Bank and Andhra Bank also improved their profits significantly.
2. If the performance of the year 2002 is a stable growth situation, then it can be said that the remaining accumulated loss would be wiped out in the course of the next five years. However, it would require a stable growth path in business generated (which crossed rupees 2,700 crore in 2002) and a steady rate of reduction of gross and net NPA.
3. Some of the other banks that launched the scheme include Allahabad Bank, Bank of Maharashtra, Canara Bank, Indian Bank, Indian Overseas Bank, Punjab National Bank, Syndicate Bank, Union Bank of India and Vijaya Bank.
4. UBI received rupees 400 crore as recapitalization funds from the government and the banking sector till date has received around rupees 20,500 crore.
5. The government also appointed Mr Madhukar to hold concurrent charge of the post of Chairman and Managing Director of Industrial Investment Bank of India, which was going through difficulties.
6. 'Diversion of funds' would be construed to include any one of the following—(*a*) utilization of short-term working capital funds for long-term purposes not in conformity with the terms of sanction (*b*) deploying borrowed funds for creation of assets other than those for which the loan was sanctioned (*c*) transferring funds to the subsidiaries or group companies or other corporate bodies (*d*) channelizing the funds to any bank other than the lender bank without prior permission of the lender (*e*) investment in other companies by way of acquiring equities or debt instruments without approval of lenders (*f*) shortfall in deployment of funds vis-à-vis the amounts disbursed or drawn and the difference not being accounted for.
7. 'Siphoning off' is deemed to occur if any funds borrowed from banks or financial institutions are utilized for purposes unrelated to the operations of the borrower, to the detriment of the financial health of the entity or of the lender.

8. Involuntary default was not a minor threat either but the point remained that banks had greater power to obtain a favourable outcome with respect to voluntary defaults. However, some involuntary defaults raised questions about risk management procedure of the bank concerned. Haldia Petrochemicals defaulted on its loan from United Bank of India for the period between October–December 2001. The bank will require to provision the amount as non-performing asset if HPL fails to pay in the next three months. UBI's exposure to HPL is of rupees 250 crore, of which around rupees 70 crore is the cash component and around rupees 100 crore is in the form of letter of credit and other instruments. The balance is in the form of bonds and debentures. The company has till March 2002 honoured its letter of credits, but defaulted on interest repayments to the bank.
9. This reflects the institutional view of history as enunciated by North in D. North (1990) *Institution, Institutional Change and Economic Performance*.

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CONCLUSION

We have already outlined most of the significant issues involved in financial intermediation in an economy. In this section we have made some concluding remarks that would be useful to scholars interested in pursuing further research in this subject. This book began with an analysis of the relationship between banking and economic development. As we traverse through time and space, the relation between banking and economic development proves to be multidimensional in nature and to a large extent irreducible. Therefore, we are inclined to shed the narrow view of banking as a means to ensure smooth flow of funds and boost the process of economic development. Instead, we have chosen an *analytic-cum-structural narrative* to elucidate how a financial intermediary evolves through the process of economic development (both in terms of contribution to development and reaping the benefits from it). This kind of analytical-structural history in a micro-set-up can pave the way for a better macro-view about financial history in general, and particularly about the developing and less developed economies. This enables us to have a better understanding of the financial and economic structure through time and the nature of causality generated by it. We conclude by indicating how one can understand the financial history of developing countries. Such an understanding requires an overview of the *financial structure*.

Banking and Economic Development

Financial structure and economic development, as mentioned before, have a two-way causality. Banking plays a crucial role in this two-way causality: it screens and monitors projects, and manages risks and acts as a strategic complement to securities markets not only through partial financing (mainly of working capital) but also in terms of sharing information and risk. Most importantly, the participation by financial intermediaries opens up the possibilities of diverse trades that can be executed through the financial markets. In turn, investors and lenders begin to trust their financial institutions and banks, and thus the growth of savings mobilization and lending increases.

Returns to scale in banking and its link with economic development are other obvious factors that can hardly be neglected. Fixed set-up costs of banks enable them to obtain economically viable sizes and financial capacity which in turn leads to the development of the economies in which they exist. Typically financial intermediaries develop specific expertise and try to grow on the basis of the acquired specialization. Of course, if there are unlimited returns to scale then the financial intermediary becomes a monopoly (of the bank in the banking industry) but limited capacity to process information and antitrust law precludes such possibilities though sometimes mega-mergers are allowed on efficiency and synergy grounds. It is important to note that the propensity of the banks to develop on the basis of comparative advantage in some areas immediately boosts the sectors financed by it like handicrafts, trade, agriculture, small-scale and large business houses. Banks keep leverage on the creation of the surplus thus generated, and design renewal strategies for growth of capital and maximization of the stream of profits.

Some classical economists and bureaucrats have highlighted the role of big banks in coordinating the *big push* from small-scale to large-scale industry. The small-scale entrepreneur has no incentive to develop his business into one that is dynamic in scale and scope. As a result, if the economy is struck at a low level equilibrium where almost everybody is a small-scale entrepreneur, the economy will tend to stagnate. Only some large-scale banking contracts can take the economy out of the low level trap. This can be done by financing projects like railway track development, irrigation canals, turnpikes, demand for routing and rerouting cash and securities between the towns and the cities, and developing a market for government and private sector bonds. With such *high powered* contracts which are lucrative and reasonably risky, the low level equilibrium will disintegrate at a fast pace. Unfortunately, it is not clear how and why the large banking organizations or the state financial apparatus will come into being, and what their incentives for ushering higher levels of growth in the economy are.

Banking innovations of smaller kinds can also influence the choice of high growth equilibrium. By providing incentive packages to a small segment of the economy, a set of banks can ensure that an economic process starts which gradually leads to a significant takeoff for the entire economy. Such inducements by the financial intermediaries are known as *small push* innovations. Relaxing collateral constraints, lending rates or loan covenants for an industry like steel can have economy-wide repercussions and high levels of growth once the structural adjustment effects work themselves out. Needless to say, banks make money though with a bit of gestation lag of returns.

Bank lending displays strategies and innovations to overcome the transaction cost challenges of development banking. Some of these like the *area approach* to lending, marketing infrastructure provision, and loans for irrigation facilities, seeds, fertilizers, pesticides and storage facilities are among the few that have already been discussed. However, measuring inputs by money was proving counterproductive even with frequent monitoring, so in the later stages of development banking a strategy was formulated in terms of outcome oriented banking—a concept which measured the actual benefits of the intended beneficiaries with respect to the inputs that they could purchase using bank loans. Unfortunately, there is not much consensus on this issue and experience varies according to types of soil and climate from one area to another and according to the nature of the farmer organizations. No wonder then, that some banks have accrued substantial non-performing assets in these kinds of lending. A crucial challenge which remains is to what extent the Grameen Bank strategy can be implemented successfully with regard to these.

Towards a Financial History of Developing Economies

The quest for economic development has resulted in models of economic growth with new explanatory variables and arguments appearing every now and then. At present, primary focus is given to the financial variables in the empirical analysis of augmented growth models. This reflects the awareness that financial complexity created in financial relationships implying micro-level as well as aggregative constraints on the growth process. This is because of the failure of explanatory power of capital, productivity and human capital to take into account the huge divergence in per capita living standards and Gross Domestic Product (GDP) growth rates across different countries. However, while economic growth and financial sector are found to be (robustly) positively correlated in most empirical studies conducted so far, there is a significant residual error in each regression (whether based on cross-country or time series data) and no observable significant correlation between financial structure and economic growth. In our mind, this is due to the fact that one defines a financial structure too crudely and usually as being bank-based or market-based. Perhaps it will be interesting to think deeper about the nature of *financial structure* and its *components*.

The basic object of this alternative mode of enquiry is the definition and dimensionality of the financial structure of a Less Developed Country (LDC). A financial structure can be proposed to be understood in terms of four primitives: (*i*) financial deepening instruments, (*ii*) financial flow networks, (*iii*) financial institutions and (*iv*) financial pyramids. The financial deepening instruments like money, credit, equity and their derivatives are those that gradually improve the allocation of real resources under uncertainty and transaction costs. The financial flow network consists of different centres of financial activities and the interconnections between them. Without externally imposed constraints, the financial flow network can create smooth financial flows of capital, credit and liquidity under a common knowledge of risk–reward structure and bring in an efficient allocation of financial resources most of the times. However, financial networks may become unstable and be accompanied by occasional wild swings in expectations and financial flows that may create micro and macroeconomic risks. The financial institution is a financial rule, a financial intermediary or a financial market that governs the financial transactions and creates an orderly way of allocating funds among alternative uses. By means of this governance structure that a financial institution brings in, the financial networks become constrained in their functioning. The financial institutions are embedded in a financial pyramid. The financial pyramid consists of layers of money markets, financial institutions, fiscal apparatus and the monetary apparatus at each level, with the depth and power of such layers increasing from the bottom to the top layer. If the state is divided in a certain manner then there can be more than one pyramid and they will have to share the aggregate financial resources in this way.

The first objective is to understand the nature of evolution of the financial structures of LDCs, provide a causal explanation for the kind of evolution that are observed with respect to financial structures, and to identify the basic forces that cause stability, history dependence or change in financial structures. The basic hypotheses that can be tested are as follows:

(*a*) The nature of evolution of financial structures in LDCs can be described in three stages. In the first stage, financially repressed development is accompanied by innovative indigenous financial networks that precisely seek to circumvent the repressing factors. In the second stage, financial deepening and financial institutional development takes place. In the final, and more recent stage, financial networks and institutions grow to a large extent and create new possibilities.

(*b*) In the first stage the institutional forces are weak and the financial depth is low, and therefore the financial structure grows through networks. However, the networks are constrained by the lack of financial instruments and the support from financial institutions. Thus, in the second stage of development, financial institutions must lead with adequate support from the state and the phenomenon of financial deepening. This stage ends with a stagnating financial pyramid and suppressed financial networks ready to bypass the state fiscal machinery. In the last stage financial networks lead the growth through financial innovation and augmented returns which gradually bring in desired change in the financial institutional pyramid.

(*c*) Given the initial financial structure, a dynamic wealth accumulation game begins under conditions of potential externalities and increasing returns. This involves coordinating around common beliefs and possible strategies. The actual working of the financial system can only be understood in the context of the coordination game. Political lobbying and legal institutions

> are extra factors added to this game causing inertia to result. This hypothesis thus argues why the financial institutions and networks in the different LDCs exhibit dependence on initial conditions and sometimes dependence on the legacy of their historical paths.

The other aspect that this kind of research project aims to investigate is how the evolution of financial structure in the LDCs have an effect on the path of economic development. The central hypothesis to be tested will be that financial architecture or structure matters in the quest for growth and development, and that the financial system continuously innovates to bring more desirable economic outcomes, provided that the pyramidal constraints are neither too high nor too low.

Should one persist with testing a myriad of growth models with financial variables of different sorts to reduce the residual errors and get higher and significant coefficients for financial structure narrowly defined as mentioned earlier? Or, should the above sketch of financial structure and the hypothesized dynamics of the financial and development process turn out to be sufficient anchor for historical narratives to be constructed that reveal interesting and substantive insights? We feel that by working boldly and innovatively, historians can shed light on the neglected areas in this field and provide a systematic view of the relation between the elusive concepts like financial *structure*, *institutions* and *development paths*. We would prefer that the interested scholar of banking will choose the latter from this menu of options. However, we recommend both roads travelled for the sake of interesting debates and for identifying common findings and complementary features.

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