Restructuring Strategy for Weak Public Sector Banks in India: A case of United Bank of India

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Abstract— **The case study focuses on restructuring strategy for weak public sector banks in India with special reference to state owned, Kolkata (India) headquartered United Bank of India. The case highlights how the United Bank of India nearly survived being wrecked in the whirlpool of sticky loans, became leaderless during the crises and still ponders on for a remedy. The case is an example of how badly managed loan books and poor use of technology can wreck disaster on any financial institution. The case goes on to highlight measures for strategic restructuring strategy for weaker PSU banks in India.**

Keywords- Bank Management, Public Sector Banks, Non Performing Assets

Introduction

It would have been a day of long contemplation and retreat for the Chairman and Managing Director of United Bank of India, Ms. Archana Bhargava before she signed her resignation papers. It was Thursday, 20th of February, 2014. Next day, banking secretary in the Ministry of Finance, Mr. Rajiv Takru confirmed that her resignation will be accepted with immediate effect and the official reason cited for her voluntary retirement was ill health. Her resignation would become the second case of voluntary retirement of a PSU bank chief in the history of Indian banking.

Bhargava was appointed chief of the state-run lender on April 23, 2013, and was supposed to be in charge till February 28, 2015. Prior to this appointment, she was one of the executive directors in Bangalore-based Canara Bank. Becoming the executive director in Canara Bank in April 2011, Bhargava led the bank's international banking, large corporate credit, priority sector, risk management, inspection and audit, general administration, financial management and various other departments. She also looked after all the nine subsidiaries of Canara Bank. A postgraduate gold medalist from Miranda House, University of Delhi, Bhargava started her career with Punjab National Bank (PNB), where she joined as a management trainee in 1977. At PNB, she worked in various key areas, including large corporate credit, priority sector, planning and development, and financial inclusion.

At UBI, she announced an ambitious plan of expanding its presence in seven or eight new countries. However, that plan was kept on hold, as the bank's earnings fell due to a sharp rise in non-performing assets(NPAs). In her first quarter in charge of UBI, the bank's net profit fell 74 per cent from a year earlier. For the next two quarters, the lender incurred a net loss of Rs 489.5 crore and Rs 1,238 crore, respectively. To add to the problem, the lender's capital adequacy ratio crashed to 9.01 per cent, according to Basel-III rules at the end of December 2013. Tier-I capital adequacy ratio was 5.59 per cent and well below the regulatory requirement of 6.5 per cent, which banks need to maintain from March 2014. Fresh slippages topped Rs 3,000 crore, expanding the lender's gross NPAs to Rs 8,546 crore at the end of the last quarter. There was talk of a growing rift between Bhargava and other senior executives of the bank over asset classification and reporting of NPAs. Following the bank's third-quarter earnings announcement (Q3, FY14), Bhargava went on leave and has now left the bank altogether. The reasons for the illness which overwhelmed the bank and lead to serious repercussion and unprecedented aftermath are now documented lessons in loan recovery and NPA management.

I. POOR FINANCIAL INDICATORS AND MOUNTING NON-PERFORMING ASSETS

A. *In November 2013 the Reserve Bank of India initiated a forensic audit of United Bank of India's books concerned by the steep deterioration in its asset quality, and in December 2013 the RBI restrained this Kolkata-based bank from advancing a loan of more than Rs.10 Crore to any single borrower and barred it from restructuring stressed loans.*

B. *The bank sent tremors across the banking sector when it reported gross NPAs at 10.89% in third quarter of FY 2013-14 which ended on 31st December 2013. Bank's gross NPAs in December'13 stood at Rs.8545 Crore, escalating increases of 194% from Rs. 2901 Crore in corresponding quarter last year.Maintaining the Integrity of the Specifications**(Table 01)***

Source: United Bank of India official website

TABLE I. FINANCIAL INDICATORS

	Q3/FY13	*Q4/FY13*	*Q1/FY14*	*Q2/FY14*	**Q3/FY14**
Operating Profit	***515.7***	***510.7***	***600.3***	***373.3***	**545.09**
Net Profit	***42.1***	***31.1***	***44.7***	***-489.4***	**-1238.1**
Gross NPA (Rs Crore)	***2901.7***	***2963.8***	***4001.7***	***6285.8***	**8545.5**
Gross NPA (%)	***4.42***	***4.25***	***5.59***	***7.52***	**10.82**
Capital Adequacy (Basel II)	-	***11.66%***	-	-	**9.03%**

Source: United Bank of India website

Between June'13 and December'13 the bank's gross NPA almost doubled from Rs. 4001 Crore to Rs. 8545 Crore and the lender booked a net loss of Rs.1238 Crores. In February 2014, after reporting the financial numbers for the third quarter of FY14, the bank's CMD, Archana Bhargava opted for voluntary retirement citing health reasons much before her tenure, due to be ending in 2015.

Following the mounting crises in this PSU bank, in February 2014 the banking regulator has started a fresh audit of the lender—this one to scrutinize loans made in the FY 2014, also directed the bank to step-up loan recovery, while the credit rating agencies downgraded the bank's ratings making any money market approach costlier for the lender.

II. SYMPTOMS OF AILMENT IN THE BANK

- Deteriorating Credit Quality
- Mounting Losses
- Weak Finances
- Low Capital Adequacy Ratio
- Unrestrained Credit Growth In Previous Couple Years
- Leadership Crises And Decision Making Impasse

III. UNITED BANK OF INDIA: ATROUBLED PAST

The UBI crises of February 2014 and the its reasons are in fact not an altogether new or sudden for this Kolkata based lender. The bank has had a troubled past. In March 1999, the confederation of Indian Industry (CII) set up an expert group to recommend solutions for the bad-debt problems of India's financial sector. The group submitted its report to the finance minister on in December 1999. CII recommended then, that the three chronically sick banks, Indian Bank, UCO Bank and United Bank of India be closed down forthwith. The report however was buried and no action was taken. In the month of October same year, the RBI had released a broadly similar report prepared under the chairmanship of M.S. Verma, a former chairman of the SBI. It selected seven parameters covering solvency, earnings capacity and profitability to identify weak banks. The conclusion was that Indian Bank, UCO Bank and United Bank of India were systemically weak banks in spite of having received a total of Rs.6,740 Crore of government funds for recapitalization in the past seven years.

14 years since then, the condition and circumstances for the bank seems to have worsened with burning questions being raised about corporate governance, mismanagement, accounting malpractices, forgery and window dressing.

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A. A brief histroy of the bank

United Bank of India (UBI) was one of the 14 major banks which were nationalized on July 19, 1969. Its predecessor the United Bank of India Ltd., was formed in 1950 with the amalgamation of four banks viz. Comilla Banking Corporation Ltd. (1914), Bengal Central Bank Ltd. (1918), Comilla Union Bank Ltd. (1922) and Hooghly Bank Ltd. (1932) (which were established in the years indicated in brackets after the names). The origin of the Bank thus goes as far back as to 1914. As against 174 branches, Rs. 147 crores of deposits and Rs. 112 crores of advances at the time of nationalization in July, 1969, at the end of Q3, FY14, the Bank was 100% CBS enabled with around 2000 branches and offices and is having a Total business of more than Rs 2 lac crore.

The bank is designated as a Lead Bank in 30 districts in the States of West Bengal, Assam, Manipur and Tripura. The Bank is also the Convener of the State Level Bankers' Committees (SLBC) for the States of West Bengal and Tripura. UBI played a significant role in the spread of banking services in different parts of the country, more particularly in Eastern and North-Eastern India. UBI has sponsored 4 Regional Rural Banks (RRB) one each in West Bengal, Assam, Manipur and Tripura. These four RRBs together have over 1000 branches. United Bank of India has contributed 35% of the share capital/ additional capital to all the four RRBs in four different states. UBI is also known as the 'Tea Bank' because of its age-old association with the financing of tea gardens.

IV. PLAUSIBLE REASONS OF SICKNESS

The forensic audit report, the Reserve Bank of India audit report and the administrative enquiry report and submitted to the Ministry of Finance of the Government of India pointed to several deficiencies in the management, systems and processes followed by the bank. These deficiencies as pointed out by a comprehensive judgment of various reports hint at executive nature deficiencies that could be addressed immediately and the other which forms the part of structural changes and which will take time to implement.

1. The issue of prime concern for the bank is that of the Non Performing Assets. The reports suggested that in various cases where the United Bank of India was in consortium lending with other banks; the group

although had implemented the corporate debt restructuring (CDR), United bank did not implement it and the assets slipped into NPA category. The reason for this inattention is attributed primarily to internal management problems which went on unresolved.

2. The bank also had the record to prove that their Core banking Solution (CBS) software had genuine glitches resulting in accounting problems in the bank.

3. The reports also hint that the decision-making process in the bank had for one reason or the other got jammed. And despite the intervention of the Government of India and the Board of Directors, the equations reached a point where the only way perhaps to sort it out was to part ways. Archana Bhargava, who became the chairperson and managing director of the bank in April 2013, opted to resign within 10 months of taking charge. The official reason cited was ill-health, even though talks of mismanagement and her growing rift with senior executives were getting louder.

4. Excessive and unmindful lending in uncertain economic environment may also be attributed to piled up problems. The bank's total advances increased by 34.2 per cent to Rs 83,636 crore at the end of September 2013 compared to the previous year. This was almost double the industry average during the period. Even on a sequential basis, the bank's advances increased 17 per cent.

V. Reasonable Remedies and Solutions

- Focus on improving asset quality
- Reduce operating expenses
- Mobilize more business and do good business
- Instead of hiding NPAs focus on recovery

VI. RESTRUCTURING WEAK PUBLIC SECTOR BANKS: M S VERMA WORKING GROUP REPORT, 1999

In October 1999, the Working Group on Restructuring Weak Public Sector Banks submitted its report under the chairmanship of Shri M.S. Verma to the Reserve bank of India. The Reserve Bank of India, in consultation with the Government of India, set up the Working Group to suggest measures for revival of weak public sector banks. This working group's mandate was to (a) formulate criteria for identification of weak public sector banks, (b) to study and examine the problems of weak banks, (c) to undertake a case by case examination of the weak banks and to identify those which are potentially revivable and (d) to suggest a strategic plan of financial, organizational and operational restructuring for weak public sector banks.

The Committee on Banking Sector Reforms (Narsimham Committee,1998) had recommended two criteria for identification of a bank as a weak bank; namely (a) where accumulated losses and net NPAs exceed the net

Operational	Human Resources	Management
1. High level and fresh generation of NPAs	1. Overstaffing	1. Lack of succession planning
2. Slow decision making process with regard to 3. Fresh sanction of advances 4. Compromise proposals	2. Low productivity	2. Short tenures and frequent changes in top management
5. Declining market share in key areas of operations, limited product line and revenue stream	3. High age profile	3. Inadequate support from the Board of Directors
6. Absence of cost control and effective MIS	4. Restrictive practices in deployment of staff have further aggravated the cost of overstaffing	-
7. Weak internal control and housekeeping 8. Poor risk management	5. Staff cost as a proportion of total operating income has been above the industry median	-
9. Insufficient customer acquisition due to mediocre service, low level of technology	6. Level of skill and low levels of motivation	-

and non-competitive rates		
10. The operations of subsidiaries and foreign branches 11. Lead bank and RRB responsibilities and location disadvantages	7. Skills in foreign exchange, treasury- -management and other specialized areas are not significant enough to generate business in these areas on a sustained basis.	-

worth of the bank or (b) one whose operating profits less the income on recapitalization bonds has been negative for three consecutive years. For Identification of a weak bank; the Verma Working Group recommended the use of total seven parameters in conjunction with the above two suggested by Narsimham Committee; namely (i) capital adequacy ratio, (ii) coverage ratio, (iii) return on assets, (iv) net interest margin, (v) ratio of operating profit to average working funds, (vi) ratio of cost to income and (vii) ratio of staff cost to net interest income (NII) plus all other income.

The group identified that the malady has been deep in the case of three banks, viz., Indian Bank, UCO Bank and United Bank of India. Continuous decline in profitability and efficiency of these banks and their dependence on capital support from government are causes for concern. The group identified that the weakness in these three banks relate to operations, human resources and management. Table 01 presents details of these three core weakness areas.

The working group insisted the three identified to prepare a revival plan and the group comments that these plans were no better than the earlier ones that had failed and were based on ambitious projections of growth in business and income for which the banks were not equipped in terms of skill or technology. The working group further comments that the revival plans should reflect growing compulsions to achieve steady growth in income and sustained control of expenditure; and as long as government assurance to continued capital infusion is there, the banks would only look at soft options regardless of the time and cost involved.

VII. RESTRUCTURING STRATEGY

The Verma Working Group insisted the weak banks to present a self-assessment and revival plan for a turnaround. The group notes that the plans prepared by the banks at the Working Group's instance were no better than the earlier ones that had failed and were based on ambitious projections of growth in business and income for which the banks are not equipped in terms of skill or technology. The group further notes that the plans did not reflect the growing compulsions of having to achieve steady growth in income and sustained control of expenditure, and it was felt that, as long as government assurance as to continue capital infusion is there, the banks would only look at soft options regardless of the time and cost involved.

The report submitted by the working group explicitly mention that any restructuring plan should not be confined only to financial restructuring but if operational aspects are not attended to the long term sustainability of any turnaround plan cannot be ensured. A plan which considers only finances may be tempting at the very first instance as it restores solvency immediately but it may exacerbate additional problems and may result in a costlier comprehensive restructuring at a later point in time.

It is tempting to confine restructuring to financial aspects since solvency is immediately restored and there is a visible impact on the balance sheet. But, if operational aspects are not attended to, long term sustainability cannot be ensured. This will only lead to additional problems necessitating further and costlier restructuring down the road.

TABLE II. CORE PRINCIPLES FOR DEVELOPING BANK RESTRUCTURING STRATEGY

Core principles			
Manageable cost	**Least burden on the exchequer**	**Sharing of losses equitably**	**Strong internal governance**
Constant progress monitoring by independent agency			

(Source: M.S.Verma Working Group on Restructuring Weak Public Sector Banks)

CORE Modalities to be used for Bank restructuring

TABLE III. MODALITIES TO BE USED FOR BANK RESTRUCTURING

Merger or closure	Change in ownership	Narrow banking	Comprehensive operational and financial restructuring
Merger and closure were both ruled out by the group citing various negative externalities affecting depositors, borrowers, other clients, employees and, in general, the areas served by the banks being closed.	Privatization is an acceptable course and will remove the moral hazard problem. However, in their present state, it is just not possible to consider their	In any case, narrow banking can at best be only a temporary phase and cannot by itself be adopted as a restructuring strategy.	The only other option left for consideration is that of a comprehensive operational and financial restructuring

	privatization because the cost of restructuring is prohibitively high and no private group can normally be expected to bring in the kind of resources that the three banks require at present.		

(Source: M.S.Verma Working Group on Restructuring Weak Public Sector Banks)

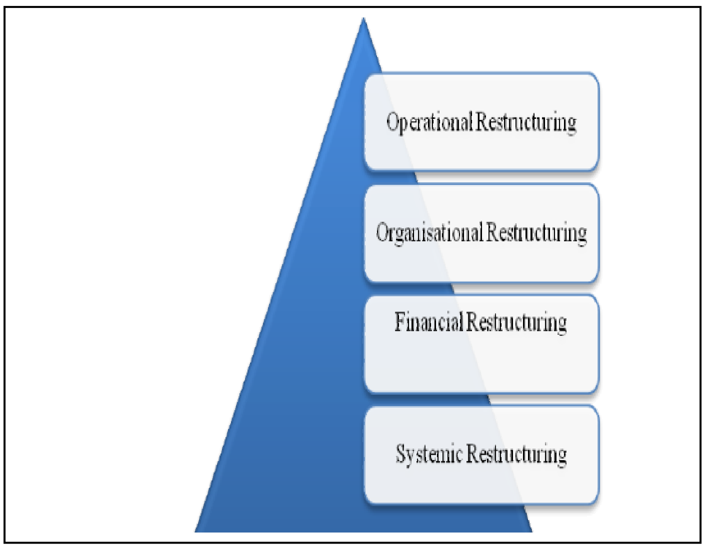

Figure 1. Restructuring Strategy *(Source: M.S. Verma Working Group on Restructuring Weak Public Sector Banks)*

- Operational restructuring involves

1. Basic changes in the mode of operations,
2. Induction of modern technology,
3. Resolution of the problem of high non-performing assets and
4. Drastic reduction in cost of operations.

- Organizational restructuring aimed at improved governance of the banks and enhancement in management involvement and efficiency.
- Financial restructuring with conditional recapitalization aimed at ensuring solvency.
- Systemic restructuring providing for legal changes and institution building for supporting the restructuring process

The working group explicitly mentions that any restructuring program must be implemented in a time-bound manner. Any delay will add to the cost of the restructuring. The different measures suggested for operational, organizational, financial and systemic restructuring are a unified package and have to be implemented as such for the desired results to be achieved. Gradualism and a policy of pick and choose from the package should be avoided as it can cause more harm than good.

VIII. POSSIBLE ROAD AHEAD FOR UNITED BANK OF INDIA

Ever since the various incidents unfolded at the United Bank of India, speculations both in the academia and the banking industry have been rife over a possible hand-twist merger of the bank with a stronger Public Sector Bank. But is this a solution to the problem of bad debts and rising NPA? Will not a merger of a weak bank with a stronger bank be an effort of hiding the problem rather than solving it? Also, will the acquiring bank be able to deal with the integration smoothly and manage the array of problems other than ones posed by the business-model such as cultural and regional? The only operationally feasible option for the United Bank of India at the present moment is to boost up measures of recovery and increase their asset quality. This however with the positive outlook of not repeating the same mistakes which they did in the past and which has left the entire Indian banking industry perplexed.

ANNEXURE # 01

Milestones for the bank:

• 1961 - The Cuttack Bank and The Tezpur Bank merged with the bank

• 1964 - Staff Training College at Kolkata (then Calcutta) was setup

• 1969 - The bank was nationalized by Govt. of India

• 1970 - Mobile branches were set up by the bank

• 1973 - Hindusthan Mercantile Bank merged with the bank

• 1976 - Narang Bank of India merged with the United Bank of India

• 1980 - Appointed as convenor of State Level Bankers' Committee in West Bengal, Tripura and Manipur

• 1993 - First branch brought under total branch mechanism

• 1995 - Crossed business level of Rs 10,000 crore

• 2006 - Crossed business level of Rs 50,000 crore

• 2007 - Rolled out first CBS branch

• 2007 - Setup United Bank Socio-Economic Development Foundation Trust in 2007 for rendering assistance to the weaker and under privileged sections of the society

• 2007 - Setup the first Rural Development & Self Employment Training Institute to provide residential training to small farmers and unemployed youth free of cost

• 2009 - Achieved 100% CBS for all its branches

• 2009 - Crossed business level of Rs 100,000 crore

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