It is said that the 21st Century will be the era of '*Darwinian Banking*', implying that only the fittest banks will survive. Cooperative banks need to shape up or face closure. This article provides an insight into the present and future of such banks and the challenges faced by them in the fast changing banking scenario in India.

URBAN COOPERATIVE BANK MERGERS

—The Road Ahead. . .

Mukund M Chitale

The Cooperative movement has an illustrious past in India. Farmers' cooperatives, sugar and cotton mills in the cooperative sector have been around for a few decades. The movement was started with a view to encouraging and empowering groups of individuals to form a society, which could take care of the needs of its members. It was on these lines that the concept of cooperative banking was enunciated to look after the financial and credit needs of the members of such cooperative societies. Today, the geographical landmass of the country is well connected by a large number of urban cooperative banks (UCBs).

The UCBs were set up with the avowed objective of promoting sustainable banking practices amongst a relatively specific target clientele *viz*., the middle income strata of the urban population. They were brought under the regulatory ambit of the Reserve Bank of India (RBI) by extending certain provisions of the Banking Regulation Act, 1949, effective from March 1, 1966. However, it is interesting to note that the Banking Regulation Act does not recognise the term 'Urban Cooperative Bank' and defines them as primary cooperative banks.

Since the opening of the economy from 1991 and the liberal stand taken by the Union Government and the RBI, many new private banks have entered the fray. The norms for opening branches have also been liberalised thereby causing direct competition to the cooperative banks from the private and public sector banks. Due to the available potential as also as a risk management strategy, these and public sector banks have become aggressive in retail banking, which was the exclusive turf of the cooperative banks.

The advent of time has brought technology to the core of the banking sector. Technology and costs (with an eye on risk management) are the real drivers of the banking business. With a clear focus on cutting costs and improving margins, private banks are able to cut down the rates at which they lend. This has attracted the business community to the private banks. Further, with a rapid increase in the number of branches that are being opened by private as well as public sector banks they are in a position to directly compete with the cooperative banks.

Some unfortunate closures of cooperative banks have taken its toll. The huge quantitative growth of cooperative banking till early nineties has been slowed down as a result.

Key Parameters

Given below is the comparison of the Urban Cooperative Banking sector's key financial indicators with those of the private and public sector banks in India.

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Particulars	Urban Cooperative Banks	Private Sector Banks (excluding foreign banks)	Public Sector Banks (including SBI and its associates)
Share Capital	2994	3028	14175
Reserves & Surplus	4990	19495	64549
Deposits	100901	268549	1226838
Cash in Hand	1235	21726	84242
Balances with Banks	6277	15115	57449
Investments	44771	134801	625678
Loans & Advances	61681	170899	632740
Other Assets	3768	16809	59792
Number of banks reported herein above	1891	30	27

Figures as of 31st March 2004 *Source: RBI Website, IBA Bulletin*

Particulars	Urban Cooperative Banks	Total Banks in India (including UCBs)	UCBs as % of total banks in India
Deposits	100901	1676044	6.41
Investment	44771	846837	5.29
Loans and Advances	61681	925827	6.66

Figures as of 31st March 2004 *Source: RBI Website, IBA Bulletin*

Given below is the State-wise distribution of Urban Co-operative Banks in India

Sr. No.	Name of the State	No. of Banks	Banks in State as % of total banks in India
1	Andhra Pradesh	133	6.91
2	Assam / Manipur / Meghalaya/ Sikkim/ Nagaland/ Tripura/ Arunachal Pradesh	19	0.99
3	Bihar/ Jharkhand	5	0.26
4	Gujarat	328	17.03
5	Jammu & Kashmir	4	0.21
6	Karnataka	300	15.58
7	Kerala	63	3.27
8	Madhya Pradesh	81	4.21
9	Maharashtra & Goa	639	33.18
10	New Delhi	16	0.83
11	Orissa	13	0.67
12	Punjab/ Haryana/ Himachal Pradesh	17	0.88
13	Rajasthan	42	2.18
14	Tamil Nadu & Pondicherry	134	6.96
15	Uttar Pradesh & Uttaranchal	80	4.15
16	West Bengal	52	2.69
	TOTAL	1926	100.00

Figures as of 31st March 2004 *Source: RBI Website*

The figures given above are to prove the formidability of the competition to the urban cooperative banks in the country. The table above gives the congregation of cooperative banks in the country. It can be observed that the UCBs are concentrated in the States of Maharashtra, Gujarat, Karnataka, Andhra Pradesh, and Tamil Nadu. The figures given hereinabove do not include the figures for the State Cooperative banks and the district central cooperative banks.

Need for Consolidation

A look at the tables given earlier shows the disparity between the UCBs and the private and the public players. Whereas 1,891 urban cooperative banks had total advances of Rs. 6,1681 crore, just 30 private banks had almost 3 times the size of those advances. The position would look even worse if we compare the profitability figures.

The size of many urban cooperative banks today is small ranging from single branch to 75 – 80 branches. As a result, a single instance of unscientific loan approval may lead the bank to a precarious financial position. The need of the hour today is to attain '*critical size*'. It is felt that only those banks, which have a formidable size in the business, will be able to face the challenges of increased competition.

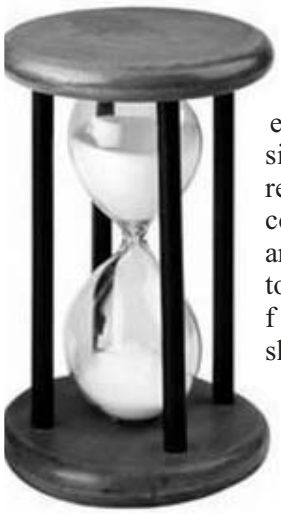
With the opening of the sectors with WTO-GATS, it is likely that many new players will enter the arena. When so many players drive the market, it is bound to lead to competitive lending rates and tighter margins. Cooperative banks need to be agile to respond to future challenges.

It is said that the 21st Century will be the era of '*Darwinian Banking*; implying that only the fittest banks will survive. Cooperative banks need to shape up or face closure.

Good corporate governance in banks has to be the focal point. The focus of business today is adding value to the services rendered by improving the corporate governance structure in banks. Consolidation is required for greater organizational restructuring aimed at improved corporate governance in banks.

The percentage of other income to the total income of the banks has been rising steadily over the years. The changes in the modes of operations of the business may result in diversification of avenues for generating additional income.

Even the cooperative banks, which are earning good profits and are well managed, will need to increase their size to remain in competition and be ready to absorb future shocks, if any.



The organisational structures of many cooperative banks are still person-centric and suffer from dominance by a few individuals.

In a nutshell, it may be stated that there is a vast differential between cooperative and private banks. Aggressive marketing, human capabilities, technology level and highest priority to customer service could be distinguishing factors. The issue is how cooperative sector gears up to meet these challenges. What should be the means to attain the goal has to be the core strategy for the cooperative banking sector as whole. Consolidation seems to be a viable option.

Benefits of Consolidation

Geographical Expansion: The RBI does not grant licenses to Cooperative banks for opening new branches as freely as it grants to private banks. A direct benefit of consolidation of cooperative banks would be that the number of branches through which the banks can service customers would grow substantially. Further, the capital costs to set up new branches would be considerably reduced.

Increase in Market Share: In addition to the increase in number of branches, the market share of the individual banks would also go up. The geographical expanse of the bank could increase manifold.

Synergy in Operations: Consolidation of two strong banks would lead to an even stronger bank. Consolidation of two weak banks can help in reducing redundant costs and operational inefficiencies caused by small size. Merger of a weak bank with a strong bank will help in giving a ready clientele and geographical expanse to the resultant bank.

Competitiveness: Competitiveness would be the key word in the future. Consolidation by mergers and acquisitions would significantly help cooperative banks become more competitive in the fiercely competitive banking sector.

Economies of Scale: As the name suggests economies of scale can be taken advantage of only when the size become critical. This helps in reducing the technological and operational costs per transaction. Further, it also enables the bank to hire professional experts, and the best technology in the industry. Size gives the bank the financial muscle to negotiate costs.

Economies of Scope: Today banks have moved into areas, which are as diverse as insurance, credit cards, and home finance. With the same set up of existing branches the consolidated bank would be in a better position to render a variety of services using the same premises and infrastructure set up without incurring any additional overheads. Thus it can take advantage of not only economies of scale but also economies of scope.

Financial services at competitive prices: One of the most important benefits of consolidation is the reduction in the costs of services brought about by operational and business synergies. Cooperative Banks can concentrate more on servicing the customer rather than competing amongst themselves for getting more deposits.

Co-opetition: Consolidation results in some banks having critical size, which compete with each other. At the same time with the increase in technological tools in the Banking sector, there might be increased sharing of resources like ATMs network, data management services, and credit information. Thus, at the front end there will be competition, and at the back end there will be cooperation to reduce costs and facilitate services.

Some cooperative banks still have a good name in the market place. Using their brand value for the benefit of weaker banks through merger should also be an advantage.

Issues involved in Consolidation

Technology: The foremost issue in the path to consolidation is to address the problem of different/no technologies being used and to bring such technologies on a common platform.

Work Culture: Subsequent to the consolidation of banks, the issue that crops up is that of work culture. The

banks with seemingly different political backdrops have varied ethics, value systems and priorities. The methods of working in two different organisations would be significantly different. It is a prerequisite to a successful merger that the work cultures of the two organisations should be integrated in an effective manner.

Human Resources: Some of the major issues that can throw up in case of consolidation are those pertaining to job security, career growth, leadership styles, and performance management structure. Rationalisation of work force will continue to be a politically sensitive issue.

The competency levels in cooperative banks are skewed. The recruitment procedures are not always scientific. Functional expertise becomes the casualty in the process. Human resources would be the critical area that would need attention in consolidation programme.

Depositors Interest: The majority portion of the depositors in a cooperative bank consists of small depositors who depend upon the returns from such deposits. In case of consolidation of cooperative banks, the ability of the new bank to repay such depositors may be in serious doubt. This fear has been taken care of by the RBI in its guidelines on merger/amalgamation of Urban Banks.

Organisational Structure: Some banks have a three-tier structure— branch, controlling offices and the head office. Many others have two-tier set up where the branches directly report to the head office. Within head offices, the functional division is sometimes not done systematically. These aspects need to be addressed in the consolidation process.

Making Consolidation a Success

(1) Pre-conditions for a healthy environment for consolidation

Cooperative Sector Reforms: The biggest problem faced by Urban Cooperative banks today is that of dual control. This problem has to be addressed. Steps also need to be taken in respect of rationalising the powers of the Registrars.

Professionalisation of Management and staff: The management of cooperative banks should have a greater proportion of professionally qualified persons. Suitability for positions should be determined on the basis of professional qualifications and experience.

Adoption of Uniform Accounting Procedures: Uniform accounting procedures and practices should be adopted using computerisation.

The biggest problem faced by Urban Cooperative banks today is that of dual control. This problem has to be addressed. Steps also need to be taken in respect of rationalising the powers of the Registrars.

The Management Information Systems should give timely and effective information.

Business Plan: Even before the consolidation process starts the consolidating banks should prepare a road map for the growth of the resulting entity. Such a roadmap should cover the long term and short-term goals of the bank and the action plan to achieve those goals.

(2) Methods of Consolidation

Vertical Consolidation: The existing 3-tier system in the cooperative banking sector could be reduced to a 2-tier system where the urban cooperative banks could receive support directly from the State Cooperative Banks. This would reduce the margins withheld by banks at each tier level and will resultantly bring down the costs and improve margins.

Horizontal Consolidation: In the cooperative banking sector this would mean geographical expansion of the bank in to various branches at different locations. There may be options— merging strong banks, or strong with weak ones or weak banks altogether, etc.

Functional Consolidation: As is the case with many private banks today, functional consolidation would enable the cooperative banks to service various short term as well as long term banking products from under one roof.

The impact of choice of merger strategy would be different in each case. The plan for future would be determined by the method of merger.

(3) RBI Guidelines on Merger/ Amalgamation for Urban Banks

As per the guidelines issued by the RBI on February 2, 2005, the ground has been cleared for consolidation activity in the cooperative banking sector. Cooperative banks have been allowed to merge/amalgamate with other cooperative banks. The salient features of the guidelines have been given below:

- A cooperative bank can merge only with another cooperative bank situated in the same state or registered under the Multi State cooperative Societies Act.
- Where the net worth of the acquired bank is positive, the acquirer bank should assure that the deposits of all depositors in the acquired bank would be protected.
- Where the net worth of the

acquired bank is negative, the acquirer bank should assure that the deposits of all depositors in the acquired bank would be protected by it or with support from the State Government extended upfront.

- The financial parameters for the acquirer bank post merger regarding prudential and regulatory requirements will have to be met.
- The realisable value of assets will have to be assessed through a process of due diligence.
- The RBI would consider the financial aspects of the merger, the interest of the depositors, and the stability of the financial system while granting permission for the merger. The acquirer bank will have to submit the draft scheme and valuation report to RBI for consideration.
- An application for merger will have to be submitted to the Registrar of Cooperative societies by the banks.
- The RBI will convey its decision to the Registrar of Cooperative Societies in the State in which the acquired bank is situated.
- The Registrars would ensure that the procedures stipulated in the Statutes have been complied with.

(4) HR issues

Cordial relations with employees: Utmost importance should be given to maintaining cordial relations between the employees of the acquirer bank and the acquired bank.

Re-training and re-skilling: When there is a change in the organisational structure, the employees need to be retrained to meet the technological challenges. Further, the skill sets required in the new organisation would be different based on the job specifications and culture of the organisation.

Challenging roles and responsibilities: It is very important to keep employees motivated, especially in turbulent times. Hence the employees should be assigned roles to deal with challenges.

Compensation and retention of key talent: The biggest apprehension in a merger process is that talented employees may feel that they would be sidelined in the new organisational structure. To counter such apprehension, the terms regarding compensation and retention of key talent in both the organisations should be made a part of the scheme of merger.

(5) Due Diligence and Valuation

The process of merger/amalgamation should be undertaken only after a detailed study of valuation and due diligence. This study should concentrate on the operational, financial, business efficiencies and inefficiencies of the two organisations. It should value the deal price after considering future opportunities, synergies and challenges.

For Cooperative Bank sector, it is the time to understand that competition in future will not be from other cooperative banks but from medium and large-sized private, public, and may be, foreign banks. Today's fragmented structure of cooperative banks will be no match for technological competence and critical size of private banks and the resultant drive down of costs and lending rates.

The Future

'Consolidation' is the buzzword in the Banking sector today. Public, Private and even foreign banks in India and abroad are deliberating upon the benefits of consolidation. It is widely felt that in the long run only 10 to 12 huge banks would prevail in India as significant players enjoying a huge pie of the banking business. With the opening of the sector, competition will only get hotter.

Cooperative banks cater to a *niche* area of banking business and thrive on cordial and close relations with customers. It is imperative that they understand their strengths and core competencies. However, instead of fighting amongst themselves for the same pie of business, cooperative banks can do well and serve well if they integrate their businesses and pass on the advantages to their customers.

It is time to understand that competition of the future will not be from other cooperative banks but will be from medium and large sized private and public (and may be foreign) banks. The fragmented structure of the cooperative banks today will be no match for the technological competence and critical size of those banks and the resultant drive down of costs and lending rates. What will sustain the cooperative banks might be the same cordial and close relations with customers that those banks may not be able to develop.

The consolidation process would challenge the existing power structure. Some may gain power at the cost of others. This may sound a threatening proposition. The effort has to be more towards becoming financially strong and have that critical business spread and size to remain so. Consolidation seems to be the obvious way! ■