From the Chair

United Bank of India Ltd

Speech of the Chairman, Dr N N Law

THE following are abstracts from the Speech delivered by the Chairman, Dr N N Law, to the Shareholders of United Bank of India Ltd., Calcutta, at the Annual General Meeting of the Bank held on April 10, 1961;

Gentlemen, „

It is my happy privilege to welcome you to this meeting. Last year your Hank has completed the first ten years of its united existence. It is heartening to note that during this period our basic progress has been satisfactory. We have been able to cross the aggregate peak deposits of the pre-merger period. We have closed 55 over-lapping branches and opened 21 new branches, a number of which are in previously unbanked areas.

Despite the tendency of deceleration which marked the growth of hank deposits last year we have been able to achieve an increase of Rs. 4.06 crores in our deposits, a rise of 8.5% over 1959. Our advances portfolio has also registered an increase of 14.7% over that of 1959.

Monetary Policy

The past year has been a significant one for Indian Banking. On the one hand, it witnessed efforts on the part of the monetary authority in playing its role actively in an attempt to control the effects of various adjustments that were taking place in the economy. On the other, there were certain developments in the country inhibiting banking progress. In the monetary field, by and large, the Reserve Hank showed its alertness and did all that was within its powers to keep the situation under control.

Deposit Insurance

In order to strengthen public confidence in banking, which was adversely affected during the past year, the Reserve Hank by sponsoring a scheme of Deposit Insurance is removing an important lacuna in the Indian money market mechanism. We now learn with a sense of satisfaction that the Government has, at last, made up its mind to give effect to the scheme. The Governor of the Reserve Hank is to be congratulated for having taken this right step for better development and growth of Indian banking. It is hoped that an appropriate scheme, suiting the needs of the situation, will be given effect to without further loss of lime,

The importance of Deposit Insurance lies not only in covering depositors' loss in case of bank failure, but more in its ability, as a trauquiliser, to firing about a general climate of confidence. However, this is not the end in itself. It is only a means to achieve the objectives of a healthy expansion and development of the banking system for sustaining the growth of the economy. Any scheme for Deposit Insurance, therefore, to be successful, will have to be designed with a view to taking care of the liabilities side of the banking balance sheet, the Reserve Rank taking eare of the assets side,

Capital Structure

Increased capital funds can be achieved in two ways, by augmentation of reserves from profits and by issue of fresh capital. I may point out. as the indices of variable dividead securities clearly show that bank shares are not thought to have growth prospects. In such circumstances it becomes ruinously expensive - and uneconomic too for banks to secure capital on the only terms on which such issues can be successful. In other words, the strength secured from an addition to capital is dissipated by the higher quantum of distribution required thereon. It would follow that whether for augmentation of reserves or for issue of fresh capital on equitable terms, the profit margins of bank operations must be enhanced.

Again, the liquidity position which the banks are required to maintain has an important influence on the profit levels which can be reached. Thus, capital funds liquidity and profitability of a banking institution are mutually the cause and effect of one another,

Liquidity

Under compulsion of circumstances liquidity is drifting downward. It is true that the liquidity position of banks in any country, at any point of time, would be a reflection of the state of activity of its national economy, extent of banking habits and coverage and pressure of legitimate demand for credit; the liquidity of banks, in the conventional sense, will reflect the degree of development and integration of the overall economic fabric of the country. In a developing economy like ours with a limited banking habit, banking liquidity will naturally tend to be lower and the pattern comparatively rigid. More so, when massive planned efforts are being made to increase the tempo of economic activities. It is also true that in these days of advanced central banking, immediate liquidity problem no longer has the significance it had in the past. Vet the basic need for liquidity in banking business cannot be ignored or its importance minimised.

Admittedly, economic expansion calls for greater credit requirements for industry and trade. But that should not eventually lead to bank finance replacing, even partly, the functions of owner capital. In so far as high taxation and low saving rate force this distortion, the phenomenon calls for immediate attention: this is important for the basic need for institutional growth. It seems that the low capital structure in the industry is being sought to be supplemented, to a noticeable extent. with bank funds. In so far as this 'tendency is responsible for the present expansion of bank advances, pushing up the advances-deposit ratio further, it could be said to he unrealistic and even disturbing; unless of course this is considered to he only a transitory phase.

Profilability

Another reason, may be the most important one, for the liquidity being placed low is the need for increased profits. The profit margins of the banks are already very narrow. With a number of major banks the profit, after deduction of taxes and bonus to the staff, for I960, as ratio to deposits, ranges between 0.17% and 0.30%. To match the mounting operating costs, therefore, banks tend to seek better earnings through larger advances. Any increase in the quantum of profit has, thus, been the result of 'double shift' in advances. This can neither be regarded as normal nor be looked upon with complacence. That even such profit has evidently failed to allow for ploughing back and make up for the decline in the investment values, is all the more a matter for concern. There is an urgent "need for a study of the structure of operating costs and operating earnings with a view to achieving a better differential.

It is surprising to note that while the advance-deposit ratio has been continuing to take an upward turn, the banks have thought it fit further to raise the rates of interest on short and other term deposits. We have been expressing our views against raising of interest rates and we still believe that the recent upward revision has been an extremely undesirable step.

Interest Rates

Over the years it has been our confirmed conviction that by and large the growth of deposits does not depend so much on the rate of interest as on the confidence which the banking system inspires, availability of banking facilities and the quality of services rendered to the community. While most of the people still live at or below the subsistence level, it would seem incorrect to assume that a feasible rise in interest rates will stimulate savings as the base for bank deposits by curtailment of consumption, particularly when the value of the Rupee is declining. The step, on the other hand will further add to the increasing expenses of the banks. If the increased expenditure were, instead, spent on opening branches in unbanked areas and improving the quality and diversifying the range of services, the banking habit would have been further stimulated resulting in mobilisation of fresh deposits; that would have been a useful investment in the future.

The higher rates of interest paid on bank deposits may tend to push the bond rate upward in regard to the future borrowings of the Government. This will cumulatively add to the burden of servicing charges, which will, for obvious reasons, have to be met by progressive "increase in taxation. Any disturbance on this account is likely to reflect itself by further complicating the difficult funding problem. In order, therefore, to prevent the servicing cost of the public debt from rising sharply, the interest rates prevailing elsewhere in the economy, particularly on bank deposits, will need to be kept under close control. The policy of varying the minimum lending rates of the banks, already initiated by the Reserve Bank, can effectively take care of the adjustments in the economy.

Peg the Rates

In this connection, I would also point to the danger of uncertainty about the future course of interest rates. it is our considered view that in the interest of present investment and also in order to bring about a healthy growth of future investment, proper steps should be taken to remove any fears of capital depreciation. To quote Keynes, "the Monetary Policy which strikes public opinion as being experimental in character or easily liable to change, may fail in its objective."

1 therefore suggest that the desirability of following the U. S. method of imposing a reasonable limit on interest rates on medium term and long term public debt should be seriously considered. It may not be necessary, however, to adopt the American method of legislative provision; a stipulation as to the maximum rate of interest to be offered incorporated in the National Plans, may, perhaps, serve the purpose equally effectively.

Tax Concession Necessary

Returning to the question of profitability, I think that by increasing the rates of interest on deposits, the banks have again postponed the opportunity of raising their low profitability. It is high time that banks took a more realistic view of the situation, kept interest rates under control and tried other methods of improving their resources and profitability. While undoubtedly banks will have to make their own efforts in this regard, it is also our view that the banking system should receive apposite assistance from the concerned authorities. Tax concessions on that part of profits, which is utilised to build up reserves and thus to strengthen the capital structure, should, for example, be seriously considered by the Government.

(NOTE:--This does not purport to be a record of the proceedings of the Annual General Meeting.)