Chapter I

RESEARCH PROBLEM AND METHODOLOGY

1.1 The Research Problem

The concept of commercial banking has undergone a considerable change during the last decade. The social control of banks followed by nationalization of 14 major commercial banks on July 16, 19691 aroused enormous expectations from the banking system in India. Their activities were extended from commercial and industrial sectors to agriculture and small scale industries to achieve the social objective of economic development.

The new banking policy, as formulated after nationalization of major commercial banks, have sought to change the very structure of commercial banking in the country. The unprecedented expansion in branches, especially in hitherto neglected unbanked rural areas, coupled with phenomenal growth in bank deposits and advances were altogether a new experience for bank management in the country. Moreover, the implementation of new banking policies required, for the first time the history of Indian banking, channellization of huge resources to the priority and the preferred sectors, including agriculture, small traders, transport operators, artisans and self-employed persons.

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1. On April 15, 1980, six more banks each with total deposits of Rs 200 crores or more have been nationalised, thereby increasing the number of nationalised banks to 20 and that of public sector banks (including State Bank of India and its seven subsidiaries) to 28.
During the twelve years since nationalisation of these banks, the bank branches have been increased from 8,000 to 32,000. The volume of business — both advances and deposits — has also gone up more than eight times from Rs 8,000 crores to Rs 68,000 crores. At the same time, the banks have made a thrust into new areas and sectors. Villages alone account for over half of the total branch expansion. The banks have also made a significant contribution to economic development by assuming special area responsibilities under the Lead Bank Scheme and initiating area credit planning. They have also made several innovations in administrative structure and operational procedures.

Despite these achievements, however, banking expansion has not reached the optimum level. Expansion has been phenomenal, but only some sections of society seem to have been benefited. The goal of taking banking system to door-steps of the people is yet to be realised. In the rural and semi-urban areas, there is one branch for 20,000 people. There are still places where the banking coverage is too inadequate. It is being realised that if the banking system has to mobilise the savings of the developing rural sector, the net work should improve considerably.

It is indeed accepted that the commercial banks during the last one decade after nationalisation have not been able to achieve fully the targets set before them. Yet whatever they have achieved, particularly in terms of branch expansion, deposits mobilisation of and advances, are no mean achievements. The one result of all these developments has been that the entire banking structure,
both at the macro and the micro levels, has become far more complex and complicated than ever before. These developments have resulted in a situation that is tantamount to a great challenge before the management of commercial banks.

It has been estimated that there may be 50,000 bank branches by the end of the Sixth Plan. Deposits are expected to increase to Rs 72,000 crores and advances to Rs 42,000 crores. The private sector advances, with reference to given target, will increase to Rs 17,000 crores, of which agricultural alone will account for Rs 7,000 crores.²

In view of the above facts, it is now being realised that the rate at which the banking activities are expanding today would soon give birth to serious problems which the present system cannot perhaps cope up with. Some experts have, therefore, started talking about re-structuring of the banking system to face the emerging responsibilities. However, re-structuring of the system will not be possible without taking some forward looking measures about the size, composition, and management of manpower resources and organisation of internal systems. Without going into the controversy of restructuring of the banking system, it may be simply stated that, whatever the form, commercial banks will have to gear themselves up to effectively face the new challenges and meet their vastly enlarged economic and social obligations.

Needless to emphasise that commercial banks have a very important role to play in economic development of the country, as any modern economic system cannot function efficiently without

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² Sinha, B.M., "Bank at Door Steps," Hindustan Times (Delhi, November 17, 1981).
an efficient banking system. The effectiveness of a banking system will ultimately depend upon the provision of efficient services as well as on the safety of depositors' funds and their investments and, above all, reasonable returns for the long term health of the banking system in the country.

Manpower planning must become an integral part of the banks' planning system. An important aspect of manpower management is the need to inculcate a sense of responsibility and discipline at all levels. There appears to be a lack of awareness among the employees of their social responsibility; nor do they fully realise that their task is to provide a specialised service to society, particularly the weaker sections. Personnel policies should, therefore, have built-in systems to assess the performance of the employees at different levels, so as to encourage good work and discourage indifferent performance through a system of carrot and stick.

It is also the responsibility of the banks to ensure that the funds at their disposal are not only utilised properly in desired channels but are also safe. Recovery of advances, which is around 50 per cent in the case of farm sector, assumes great significance in this context. The fact that funds of commercial banks and financial institutions locked in sick industrial units are to the tune of Rs 2,000 crores is also a cause of concern. Moreover, the rising cost of operations coupled with declining efficiency of bank personnel and poor management practices relating to routine work like cash management, reconciliation of inter-bank and intra-bank transactions, and compilation and dissemination
of information at various aspects of field level activities have adversely affected the profitability and effective accomplishment of the avowed objectives of the commercial banks.

In recent years, therefore, considerable concern has been shown in the country about increasing costs and decreasing profitability of the banking industry, in general, and the nationalised banks, in particular. The operating expenses of the Indian scheduled commercial banks have been showing a rising trend over the period of the last one decade. Although the nationalised banks are now expected to play a different role in the economic uplift of the country by helping more and more the weaker sections of the society and by opening more and more number of branches in the unbanked and rural areas, the peculiar nature of the banking industry that deals in borrowed funds precludes a situation which keeps or may keep a bank in the red for any considerable period of time. The monetary authorities and the bank managements in India are, therefore, rightly concerned with the problem of rising costs and their impact on profitability. The solution of this problem would perhaps lie, *inter alia*, in formulating an efficient management control system for commercial banks that would keep the costs in check and increase their profitability without jeopardising the basic objectives of the banks under the new banking policy.

1.2 Need for the Study

It is neither possible nor intended to provide in a study like this a complete framework for management control systems of commercial banks. One of the important ingredients of a control system is to evolve a scheme of effective evaluation of performance.
In addition to the various problems confronting the banking system as a whole, there are certain problems which are unique to these banks individually. As such, the performance of individual banks is not alike; there are wide variations in their performances.

The fourteen nationalised commercial banks have already operated for well over a decade. It is high time that their performance be evaluated both at the macro and the micro levels to find out how far they have been successful in implementing the new banking policies and fulfilling the aroused hopes of the public, in general, and weaker sections of the society, in particular. There is, therefore, the need for a study that would make an overall appraisal of commercial banks have done in this respect during the period since nationalisation and to suggest how best they can make more effective contribution in achieving the objectives of economic development with social justice. An investigation into the performance of commercial banks is likely to generate necessary data in desired form and quantity that may not only be useful to policy makers and bank managements alike, but may also help in developing an integrated system of performance evaluation itself.

It is indeed accepted that in the case of commercial banks the measurement of performance is relatively more complex, thanks to the presence of multiplicity of objectives. Banking, although a specialised field, is interdisciplinary in the approach involving, besides the principles and techniques of banking, the study of different subjects, such as accounting and book-keeping, economics, law and management. Moreover, the banks have taken rapid strides to improve the geographical and functional coverage, as the entire
The gamut of Government's economic policy has been reoriented in recent years to bring about a better regional balance and a more egalitarian economic base. The traditional myth of commercial banking based on profitability, liquidity and safety has given way to public utility. Yet this utility orientation is not completely devoid of reasonable profit. Thus, with the increasing complexity of modern banking operations and the growing involvement of banks in various types of specialised fields of lending and services, the measurement of performance has become more complex.

Under the circumstances, it becomes all the more necessary to develop a system of performance evaluation that takes cognisance of these multiple, and often contradictory, objectives. The system envisaged must be capable of providing information that (a) directs managers towards decisions that are goal-congruent, (b) provides feedback (evaluation of performance) that ensures better motivation and improves future decisions, and (c) preserves autonomy.  

The evaluation of performance is an integral part of the planning and control system. A planning and control system, based on responsibility accounting, supports the creation of various decision-centres throughout an organisation with a view to tracing costs and revenues to the individual managers who are primarily responsible for making decisions about the cost and revenues within the sphere of their authority. Motivation is the over-riding consideration in the system that influences top management in

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formulating and using performance measure as well as designing control system. The system and techniques are so designed as to impel decision-centre and branch managers towards overall management objectives, or goal congruence. There are a variety of tools and techniques that are available for analysing financial and other data to achieve this objective as well as to measure performance.

The present project is, however, principally concerned with the performance evaluation at the individual bank level, including the evaluation of performance of the network of branches for control purposes. It is in the fitness of things to point out that the overall performance of a commercial bank depends not only on its corporate policies, but also on the performance of its branches. For, it is through its network of branches that a bank seeks to achieve its major objectives. Obviously, the overall performance of a bank is a function of its branch level performance. The approach in the present study is, therefore, more in the nature of a micro-analysis, albeit an inter-firm comparison as well as a comparison of the performance of individual banks with that of the banking system as a whole has also been made, so as to evaluate the performance of these banks in the right perspective.

1.3 Objectives of the Study

The overall objective of the study is to evaluate the performance of commercial banks in the nationalised sector with a view to evolving sound criteria for performance appraisal at the inter-bank as well as at the intra-bank level. An attempt has
also been made to build up an evaluation model for performance evaluation that may be conveniently used by bank management in India. More specifically, the objectives of the present study are:

1. to examine the prevailing system of performance evaluation in commercial banks;
2. to review the performance of selected commercial banks and their branches in terms of different variables related with their policies and plans;
3. to develop a series of general criteria for evaluating the branch level as well as overall performance; and
4. to develop, on the basis of above, a model for the evaluation of performance to be used by bank managements for planning and control of performance.

1.4 Research Design

At present, the number of banks in the public sector is 28, one-third of the total number of scheduled commercial banks (excluding RRBs) in the country. But their size and geographical coverage is quite large. They account for over 90 per cent of the entire banking business. The public sector banks include:
(a) State Bank of India and its seven subsidiaries, (b) fourteen major commercial banks nationalised in 1969, and (c) six banks nationalised in 1980. The major changes and developments, that have been referred to in the preceding pages, have come about as a result of the nationalisation of 14 commercial banks. These banks have undergone sudden and unprecedented changes after nationalisation, for which they were probably not fully prepared or equipped. Their problems are thus unique and significant, requiring in-depth investigation and analysis. Moreover, they have already worked for well over a decade. The scope of the
present, therefore, been restricted to the 14 nationalised banks.

In view of the above, 14 banks/nationalised sector constitute the census for the present study. Keeping in view the limited time and resources at the disposal of the researcher, it has been decided to select two nationalised banks — one large and one small — for detailed field investigation. For this purpose, stratified random sampling method has been used.

The stratification has been done on the basis of bank size in terms of total deposits. As it has been proposed to evaluate the performance of the sample banks over a period of ten years, 1970-79, the mid-point of the decade of seventies, has been taken to determine the size of these banks for the selection of the sample. Thus, the average deposit figures for the two years ending June 1974 and 1975 have been calculated to arrange all the 14 banks in descending order.

Using the quartile method, all the 14 banks have been classified into three size-groups:

(a) LARGE — banks above the first quartile ($Q_1$).
(b) Middle — banks falling between $Q_1$ and $Q_3$.
(c) SMALL — banks below the third quartile ($Q_3$).

It may be seen from Table I.1 that four banks, viz. Central Bank of India, Bank of India, Punjab National Bank, and Bank of Baroda, fall under the large size groups. Another four banks, viz. Indian Bank, Allahabad Bank, Indian Overseas Bank, and Bank of Maharashtra, constitute the small size-group, the remaining $Q_1 = $Upper quartile; $Q_3 = $Lower quartile; $Q_1$ and $Q_3 = $Spread between upper quartile and lower quartile. The above definition is in view of values being arranged in
<table>
<thead>
<tr>
<th>Name of the Bank</th>
<th>Average Deposits</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Large Size-Group</strong></td>
<td></td>
</tr>
<tr>
<td>1. Central Bank of India</td>
<td>958.0</td>
</tr>
<tr>
<td>2. Bank of India</td>
<td>790.0</td>
</tr>
<tr>
<td>3. Punjab National Bank</td>
<td>772.0</td>
</tr>
<tr>
<td>4. Bank of Baroda</td>
<td>676.0</td>
</tr>
<tr>
<td><strong>Average Size-Group</strong></td>
<td></td>
</tr>
<tr>
<td>1. Canara Bank</td>
<td>499.0</td>
</tr>
<tr>
<td>2. United Commercial Bank</td>
<td>443.0</td>
</tr>
<tr>
<td>3. United Bank of India</td>
<td>414.0</td>
</tr>
<tr>
<td>4. Union Bank of India</td>
<td>381.0</td>
</tr>
<tr>
<td>5. Syndicate Bank</td>
<td>376.5</td>
</tr>
<tr>
<td>6. Dena Bank</td>
<td>295.5</td>
</tr>
<tr>
<td><strong>Small Size-Group</strong></td>
<td></td>
</tr>
<tr>
<td>1. Indian Bank</td>
<td>257.5</td>
</tr>
<tr>
<td>2. Allahabad Bank</td>
<td>233.0</td>
</tr>
<tr>
<td>3. Indian Overseas Bank</td>
<td>224.5</td>
</tr>
<tr>
<td>4. Bank of Maharashtra</td>
<td>205.5</td>
</tr>
</tbody>
</table>

six banks falling under middle-size group. One bank each from the large and the small size groups has been randomly selected for the purpose of the present study. These banks are Punjab National Bank and Allahabad Bank, referred to in the forthcoming analyses as Bank X and Bank Y, respectively.

As regards the evaluation of branch-level performance, the two randomly selected banks — Bank X and Bank Y — provided the sample for branches for the present study.

Since the focal point of the study is the development of a generic evaluation model that could be used by bank managements for evaluation of their performance both at the inter-bank and branch levels, the size of the sample does not assume too great a significance. It is, however, important to ensure that different types of branches, such as urban, semi-urban and rural, must be included in the sample. This is because of the fact that these three categories of branches not only operate in different types of setting, but they also have different targets set before them. A system of evaluation — as also of planning and control — must take these differences into consideration.

In view of the above facts, it was decided to select a limited number of branches, manageable by a single researcher. Another factor in selecting the sample was that the sample branches should be selected from the state/zone/region where there were the heaviest concentration of branches of the banks under study. Preliminary data collected from these banks indicated that while Bank X had the maximum number of branches in North Zone, particularly
the State of Punjab, accounting for 32.9 per cent of its total number of branches, the State of U.P. had the heaviest concentration of 37.6 per cent of the branches of Bank Y. As such, the sample was drawn from these two zones/states. The number of different categories of branches in the above-mentioned zone/state, the sample size and the sample fractions respectively for the two banks under reference are given in Table I.2.

Within the predetermined sample size and in consultation with the regional managers and other officers of the regional offices at Ludhiana and Lucknow, the different categories of branches were selected, on the basis of convenient sampling, from the states of Punjab and U.P. for Bank X and Y, respectively. The regional managers were requested to issue letters of introduction to the managers of sample branches individually. This helped a great deal in the collection of branch-level information. The names of the sample branches appear in Appendix B.1 and B.2.

Admittedly, limiting the sample to only two banks and 60 branches (35 + 25) restricts the extent to which the results can be generalised. However, this is not a serious problem, since the study investigates into the performance appraisal of banks and their branches on the basis of which a generalised model could be developed. The basic purpose of the study is not merely to analyse the performance of sample units; this at best provides an illustrative analysis of performance. The study, hopefully, aims at devising a system/model of performance appraisal at inter-bank and intra-bank levels with a view to facilitating better planning
### Table 31.2 Number of branches and sample size—Bank X and Bank Y

<table>
<thead>
<tr>
<th>Population group</th>
<th>Rural</th>
<th>Semi-urban</th>
<th>Urban/metropolitan/port-towns</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Bank X</strong>: as on end December 1979</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total number of branches</td>
<td>635</td>
<td>417</td>
<td>492</td>
<td>1544</td>
</tr>
<tr>
<td><strong>Northern Zone</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Amritsar</td>
<td>50</td>
<td>24</td>
<td>10</td>
<td>84</td>
</tr>
<tr>
<td>Chandigarh</td>
<td>33</td>
<td>20</td>
<td>10</td>
<td>63</td>
</tr>
<tr>
<td>Rohtak</td>
<td>33</td>
<td>22</td>
<td>3</td>
<td>58</td>
</tr>
<tr>
<td>Jalendhar</td>
<td>46</td>
<td>15</td>
<td>14</td>
<td>75</td>
</tr>
<tr>
<td>Ludhiana</td>
<td>34</td>
<td>23</td>
<td>18</td>
<td>75</td>
</tr>
<tr>
<td>Himachal Pradesh</td>
<td>59</td>
<td>7</td>
<td>-</td>
<td>66</td>
</tr>
<tr>
<td>Delhi</td>
<td>1</td>
<td>2</td>
<td>84</td>
<td>87</td>
</tr>
<tr>
<td><strong>Total</strong>:</td>
<td>256</td>
<td>113</td>
<td>139</td>
<td>508</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>(32.2%)</td>
</tr>
<tr>
<td></td>
<td>19</td>
<td>9</td>
<td>7</td>
<td>35</td>
</tr>
<tr>
<td></td>
<td>7.4</td>
<td>8.0</td>
<td>5.0</td>
<td>6.9</td>
</tr>
</tbody>
</table>

**Bank Y**: as on end June 1980

| Total number of branches | 408   | 214        | 260                           | 882   |

| Uttar Pradesh Zone |       |            |                               |       |
| Allahabad         | 41    | 13         | 18                            | 72    |
| Kanpur            | 51    | 18         | 13                            | 82    |
| Lucknow           | 80    | 19         | 9                             | 108   |
| Merrut            | 21    | 21         | 28                            | 70    |
| **Total**:        | 193   | 71         | 69                            | 332   |
|                  |       |            |                               | (37.6%) |
|                  | 16    | 5          | 4                             | 25    |
|                  | 8.3   | 7.0        | 5.9                           | 7.5   |

Source: Head and Zonal/Regional Offices of X and Y banks.

*Sample of 35 branches has been drawn out of total of 508 branches of Bank X. Sample of 25 branches has been drawn out of total of 332 branches of Bank Y.*
and control of bank operations at the micro-level.

I.5 Research Instrument

The choice of the research instrument was influenced by a number of considerations. Maximum information with minimum interference with busy work schedules of bank managers/officers was a pre-requisite. For this reason, it was decided that the research instrument would be a separate extensive questionnaire for H.O. and branches to be followed by personal interviews of Managing Director and other senior officers at the H.O. and branch managers and loan officers, if any, at the branch offices.

Before the questionnaires were prepared, an extensive desk research was carried out to determine the exact requirement of data for indulging in a meaningful appraisal of performance. Keeping in view the data need, detailed discussions were held at the Head Offices and Regional Offices of the sample banks, so as to find out the quantity, quality and form of data that could be made available at the H.O., regional offices and branches. Equipped with the above information, detailed questionnaires were prepared. Copies of the H.O. questionnaire were given to some senior head-quarter officers of both the banks for their comments and suggestions and, in the light of these as well as further discussions, it was finalised after necessary modification. To finalise the branch level questionnaire, a pilot survey was conducted; discussions were also held with the branch managers and regional managers. The questionnaire was thus reviewed, modified and finally cyclostyled.
In addition to the two comprehensive questionnaires mentioned above, a small two-page questionnaire was also prepared for determining the perceived significance of various funds and non-funds activities of commercial banks and their branches. These activities, viz., deposits, priority sector and other advances, recovery, house-keeping, inspection, profitability, C/D ratio, etc., were listed separately and branch managers as well as selected officers from H.O. and Regional Offices of the sample banks were required to assign them appropriate weights from 1-10 on the basis of the perceived significance of each variable for evaluation of performance.

All the three questionnaires appear in Appendices C.1 to C.3.

The questionnaires were served personally both at the head office levels and branches. Wherever data could be available from the files and various returns periodically filed by the branches, the branch managers were not disturbed as the relevant files were readily made available to the researcher. For other information, particularly relating to personnel, manager's profile and opinions, the branch managers and other senior officers (the latter at the head office and regional office levels in particular) were interviewed personally.

The primary data were collected through field investigation during June-October, 1980 and related to the period 1978 and 1979 for branches. For the bank as a whole, apart from some specific information as detailed in the questionnaire, the data on deposits, advances, priority sector lending, profitability, etc
were collected for ten years, 1970-79, from the annual reports,
published accounts, and other documents provided by the banks.  
Data relating to banking industry as a whole were collected
from secondary published sources, particularly RBI publications
like RBI Bulletins, Reports on Currency and Finance, Reports
on Trend and Progress of Banking in India, and Reserve Bank
of India Annual Reports for different years.

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