CHAPTER II

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CHAPTER 2

FINANCIAL MANAGEMENT AND BANKING

AN OVERVIEW

FINANCIAL MANAGEMENT

2.1 Importance of Finance in Banks

The Indian banking industry has undergone a sea change over the last 150 years. There were only 96 banks with just Rs. 1019 crore deposits and Rs. 424 crore of credit in 1947. Today, the deposits amount to Rs.3016260 crore and credit Rs. 2154912 crore.\footnote{Prabhu R Pai. \textit{Theory and Practice of Banking} (Bangalore: Prabha Publishers, 2007) 399.} In the past eventful decades banks have played a commendable role in promoting savings and investments, helping the nation in its march towards economic independence. The growth is highly impressive. The decade of 1990s was a turning point for the Indian banking industry. It witnessed a complete transformation in the way banking was carried out in India. It
has matured into a stable, strong and vibrant financial entity, with a primacy of place in providing funding for the economy. In short, finance is regarded as the life blood of a banking enterprise. This is because in the modern money-oriented economy, finance is one of the basic foundations of all kinds of economic activities. It is the master key which provides access to all the sources.

2.2 Meaning of Bank Finance

Strong capital will not guarantee liquidity in all circumstances. Bank finance may be defined as the provision of money at the time it is wanted. As a management function it has a special meaning. Banking finance function may be defined as the procurement of funds and their effective utilisation. One of the authoritative definitions is as follows:

“Banking finance can broadly be defined as the activity concerned with planning, raising, controlling and administering of funds used in the business”\(^{35}\)

2.3 Meaning of Financial Management in Banks

Financial Management in banks is the process of managing the financial resources, including accounting, financial reporting, budgeting, collecting receivables, risk management, and insurance for a bank.\textsuperscript{36} It simply means dealing with management of money matters. In financial management we mean efficient use of economic resources namely capital funds. Financial management is concerned with the managerial decisions that result in the acquisition and financing of short term and long term credits for the bank. Here it deals with the situations that require selection of specific assets, or a combination of assets and the selection of specific problem of size and growth of an enterprise. The analysis deals with the expected inflows and outflows of funds and their effect on managerial objectives. In short, it deals with procurement of funds and their effective utilization in the banks. So the analysis simply states two main aspects of financial management, namely, procurement of funds and an effective use of funds to achieve bank’s objectives.\textsuperscript{37}


2.3.1 Procurement of Funds

Financial management of banks constitutes risk, cost and control. The cost of funds should be at minimum for a proper balancing of risk and control. Funds can be procured from multiple sources; the procurement of funds is considered an important problem of banks. Funds obtained from different sources have different characteristics in terms of risk, cost and control. Funds issued by the issue of equity shares are the best from the risk point of view for the bank as there is no question of repayment of equity capital. From the cost point of view equity capital is the most expensive source of funds as dividend expectations of shareholders are normally higher than that of prevailing interest rates. In the globalised competitive scenario, mobilisation of funds plays a very significant role. Funds can be raised either through the domestic market or from abroad. Foreign Direct Investment and Foreign Institutional Investors are the two major sources of raising funds. The mechanism of procurement of funds has to be modified in the light of requirements of foreign investors.

2.3.2 Utilization of Funds

Effective utilization of funds is an important aspect of financial management, avoiding the situations where funds are either kept idle or proper uses are not being made. Funds procured involve a certain cost and risk. If the funds are not used properly then running a bank will be too difficult. In the case of dividend decisions this is also considered. So it is crucial to employ the funds properly and profitably.

2.4 Scope of Financial Management in Banks

Sound financial management is essential in all types of banks. Financial management is essential in a planned economy as well as in a capitalist set-up as it involves efficient use of the resources. From time to time it is observed that many banks have been in crisis because of the mismanagement of financial affairs. Financial management optimizes the output from the given input of funds. In a country like India where resources are scarce and the demand for funds are many, the need of proper financial management is required. In case of newly started banks with a high growth rate it is more important to have sound financial management since finance alone guarantees their survival. Financial management is very important in case of non-profit organizations, which
do not pay adequate attention to financial management. A sound system of financial management has to be cultivated among bureaucrats, administrators, engineers, educationalists and public at large.\(^{39}\)

Some of the most important functions of banks are financing, investment and dividend decisions. A bank has to secure capital that it needs for banking activities to get return on invested capital and to distribute the profit among the providers of capital. The web diagram below (Fig-F 1) indicates that the functions of a financial management can be divided into three heads.\(^{40}\)

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**Fig. F 1:** Financial Management in Banks

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2.4.1 Financing Decision

Here the finance manager has to determine about the best financing mix or capital structure. Another factor to determine is about when, where and how to acquire the fund to meet the monetary requirement of the bank's investment. The core issue is to determine the proportion of debt/equity mix and this is called the firm's capital structure. Here the manager strives to obtain the best financing mix i.e. the optimum capital structure. Optimum capital structure is that combination of debt and equity where the market value of share is maximised. The equity shares are the best from the risk point of view for the bank. From the cost point of view, equity share capital is the most expensive source of fund. This is because the dividend expectations of shareholders are normally higher than the interest rate. Further the issue of equity shares may dilute the control of the existing shareholders. However, the debenture as a source of fund is comparatively cheaper. Debentures entail a higher degree of risk since they have to be repaid as per the terms of the agreement. The

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interest payment also has to be made whether the company makes profit or not. So a finance manager, while procuring funds must consider the following three factors, namely, cost, risk and control. The cost of the fund has to be at the minimum but with proper balancing of risk and control factors. Procurement of funds will include the three steps, namely, identification of sources of finance, determination of finance mix and raising of funds. In the age of globalisation, only the procurement of fund is not enough. The resources must be mobilised through innovative ways or such financial products, which caters to the needs of investor's viz. multiple option convertible bond. Further funds can even be raised from abroad. But the pros and cons of resources from abroad must also be considered.

2.4.2 Investment Decision

The finance manager is also responsible for the effective utilisation of funds. Now one thing is very sure that funds can be procured only after assuming a particular degree of risk and cost. If the funds so procured are not utilised in an effective way so as to give a return higher than the

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cost associated with the funds, there is no point in running the banks. So the funds have to be invested in such a way that the banks can produce at its optimum level without endangering its financial solvency. Thus financial implications of each investment decision are to be thoroughly analysed.

2.4.2.1 Capital Budgeting Decision

Capital budgeting decision is essentially concerned with the evaluation of investment projects requiring long-term commitment of funds so as to ensure long term benefits of the bank. This is done through techniques of capital budgeting decision of allocating the capital in the long-term assets that would yield the return in future. The important aspects to be considered here are evaluation of profitability of new investment and measurement of cut-off rate against which the return on new investment can be compared. Investment decision is very important as the project is to be evaluated on expected profits and prediction about future is never

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easy. Further, the importance of investment decision increases as a large amount of money is involved.

### 2.4.2.2 Current Asset Investment Decision

This involves the management of cash, receivables and total working-capital that affects the earning prospects of a firm, liquidity and solvency. Here the manager has to decide how much fund is to be invested in each and every item of current assets and to manage those efficiently.\(^{44}\) This ensures that too much funds are not blocked in stock, debtors and cash etc.

### 2.4.3 Dividend Decision

This decision involves the idea whether the profit is to be distributed or retained. This is also to be based on maximisation of the market value of shares of the bank.\(^{45}\) Hence the dividend policy is considered the best, which optimises the market value of shares. At the time of taking this

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decision, availability of cash, legal requirements and certain other factors are also to be considered.

2.5 Objectives of Financial Management

It has traditionally been argued that the objective of the banks is to maximise the profits. Hence the objective of financial management is also considered to be profit maximisation. This implies that finance manager must make his decision in such a manner that the profits are maximised. However it cannot be the sole objective of the banking business. There is another objective of finance manager and that is wealth maximisation.46

2.5.1 Profit Maximization

This means maximisation of the rupee income of the bank. So under this theory the firm has to produce maximum output from a given amount of input, or minimises the input for a given amount of output or the bank has to increase the market price of its product, or services or to reduce the amount of expenditure. In the perfectly competitive market the above

is really difficult and almost impossible to achieve. It is considered as a short-term theory and the following are its criticisms.

- There is a direct relationship between risk and profit.
- Profit maximisation theory does not take into account the time pattern of returns, which is the most important consideration.
- The objective of profit maximisation is too narrow. 47

2.5.2 Wealth Maximization

It means the maximisation of the wealth of the shareholders. The objective of the company is to create value for its shares. The market price of the equity shares is in turn a function of the bank’s investment, financing and dividend decisions. The value of the bank takes into account present and prospective future earnings per share, the timing and risk of these earnings, the dividend policy of the firm and many other factors that bear upon the market price of the stock. The market price serves as performance index of the firm's progress and it indicates how well the management is doing on behalf of its shareholders. It is again beyond doubt that market price of a stock in the share market is the

result of a typical mixture of a lot of factors like, general economic condition, particular economic condition of the industry to which the stock belongs, technical factors, mass sentiments and so on. However in the long run, the market price of the share of a bank does reflect the value, which we put on a company. The value is a function of two factors, namely, the likely rate of earning per share of the bank and the capitalisation rate. The likely rate of earning per share depends upon the assessment as to how profitably a bank is going to operate in the future. The capitalisation rate reflects the expectations of the bank's shareholders. The finance manager has to ensure that his decisions are such that the market value of the shares of a company in the long run is maximised. This implies that the financial policy has to be such that it optimises the earning per share, keeping in view the risk and other factors in mind. Wealth maximisation is therefore a better objective for a commercial undertaking since it represents both return and risk.48

2.6 Risk and Return

A bank carries its operations in an environment which is not within its control. It is exposed to all sorts of dangers both on account of internal as well as external factors. Here the relation between risk and return is analysed and also outlines the major areas with respect of risk and return regarding which the finance manager has to take decisions for maximising the banks wealth. Fig-F 2 shows how decisions, risk, return and market value are related.\(^{49}\)

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**Fig. F 2:** Decisions, Risk, Return and Market Value

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2.7 Risk Management of Banks

Risk management has been a very important component of business plan for the banks and an undercurrent of risk mitigation and planning has always been part of the banking business. There have been conscious efforts in minimizing the risk without affecting the business opportunities since the early days of banking. However the increasing volume of business and complexity in financial transactions and instruments involved and the depth and nuances in risks faced have considerably increased.\(^{50}\)

Various economy cycles, market volatility, corporate irregularities and troubled capital markets have shaken the banking industry number of times and highlighted the dangers of poor risk management. With the increasing globalisation and technology driven distribution channels, the traditional risk management systems appear to be inadequate to capture inter-linkages between various types of risks across geographies, customer segments and business lines.\(^{51}\)

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2.7.1 Market Risk

One of the significant factors, which concern financial institutions, is the market risk. The prices of commodities such as crude oil remain high and the stability of the financial markets depends on the stability of the crude oil prices to a large extent. The trade balance has shifted towards the emerging economies and mounting foreign exchange reserves of these economies can certainly have some effect on the global financial markets.\(^{52}\) The changes in the global financial markets will have a major effect on the Indian financial market as the Indian markets are getting integrated into the global systems.

2.7.2 Credit Risk

Credit risk can be defined as probability that a borrower will not repay all or a portion of a loan on time. Credit risk can be regarded as an inherent component of the banking business.\(^{53}\) The introductions of customized banking products and services have made the task of judging the risk impact of credit decisions even more challenging. The increasing


inter-linkages amongst various financial institutions since late 1980’s have ensured that any risk event experienced by one institution has the potential to impact others also and the financial system in general, which is termed as Domino effect.

2.7.3 Operational Risk

Another area of concern for risk managers is the operational risk. Banks should give due weightage for operational risk along with the credit risk and market risk to ensure that the smooth functioning of the banks are not restricted by their expansion or market dynamics and the systems that are in place should be in congruence with the business volumes and the risk taken by the banks.54

2.8 Basel I and Risk Management

An appropriate risk management system is required for any organisation to mitigate the risks-emerging out of business lines and inherent in their processing mechanisms.55 In order to have uniform standards


internationally among banks, the Bank for International Settlements (BIS) formed a Committee on Banking Supervision (BCBS). The committee made several efforts in laying down the minimum capital standards and in 1988 it came out with an accord, which is known as Basel Capital Accord (also known as Basel I), to ensure a level playing field in terms of capital required to be maintained by internationally active banks. The Basel I accord was quite simple and it adopted a straightforward “one size fits all” approach. However, the accord was marred by certain limitations.

2.9 Basel II and Risk Management

The new Basel Accord is a set of recommendations on banking regulations that have formed to evolve an international standard for banking practices especially in terms of risk management. The limitations led 1988 Accord (I) of Basel committee in vague in respect of Capital Requirements for banks. In order to improve credit risk management and monitoring so that the capital requirements of banks are more in line with the nature of risks they are exposed to, the Basel Committee proposed a new Accord in 1999 (Basel II Accord) that
replaced the Accord of 1988. The capital requirement under new accord will be risk sensitive and shall differentiate each borrower in terms of risk.\textsuperscript{56}

The committee had, in June 1999, initiated the process of reviewing the Accord and making it more comprehensive and risk-based. Accordingly, the committee finalized Basel II Accord and realized the same on June 26, 2004. Basel II Accord stipulates risk-sensitive capital charge for Credit Risk and Operational Risk. The new Basel II Accord is driving banks to adopt more comprehensive risk management systems with an objective to optimally utilize the scarce capital. The Basel II requirements drive the banks to improve methods for measuring and managing credit, market and operational risks. The methodologies for computation of capital charge for market risk assumed by the banks are covered by an amendment to Basel I Accord, which is adequately sophisticated.

Basel II is aimed at not just sensitizing capital to the risks assumed by banks but also aligning the strategies and policies of the banks to Risk

Management. In other words, Business Strategies and Risk Management of banks need to move together.

2.10 Return Assessment of Banks

One of the prominent functions of the financial manager is to measure return which the bank earns on account of its operations. The return represents the benefits derived by a banking business from its operations. Different financial managers give different meanings to these benefits and hence there are different approaches for the measurement of return. The profit approach means that the return from a banking business is measured on the basis of the profit it earns. The term income approach has a more specific and definite meaning as compared to the term profit. Income always indicates that a precise accounting process has been followed in its computation. Hence income may be defined as “accounting measurement of profits”. According to cash flow approach, the return from a banking business is measured in terms of cash flows generated by it due to operations during a particular period. The term ratio approach means the mathematical relationship between two figures. A financial manager uses different accounting ratios for measuring and
comparing the performance of the bank over different time periods or of one bank with another.

2.11 Risk-Return Trade Off

The prime objective of the financial manager of the bank is to maximise the value of the firm, which is possible only when well balanced financial decisions are taken. A bank taking more risk shall definitely expect more return than other banks taking lesser or no risk. The relationship between risk and return can be illustrated as follows

Expected Return = Risk free rate + Risk premium

- Risk free rate is the compensation for time
- Risk premium is the compensation for risk

The higher the risk of an action the higher will be the required rate of return. A proper balance between return and risk should be maintained to maximise the market value of the bank’s shares. Such balance is called risk - return trade-off. The manager should strive to maximise the return for a given amount of risk. So inflow and outflow of funds should be

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constantly monitored to ensure that no undue risk is being taken and the funds are properly safeguarded.

2. 12 Cost of Capital

The cost of capital of a bank is the minimum rate of return that it must earn on its investments in order to satisfy the various categories of investors who have made investments in the form of shares, reserves and surplus or deposits.\(^58\) A bank's cost of capital is nothing but the weighted arithmetic average of the cost of the various sources of finance that have been used by it.

2.13 Determining the Cost of each Capital Component

Capital components are the types of capital used by banks to raise fund. They include the items on the left side of a firm's balance sheet (share capital, deposits, reserves and surplus). Any increase in the bank's total assets must be financed by one or more of these capital components. Capital is a necessary factor of production, and has a cost. The cost of each component is called the component cost of that particular type of

capital. Cost of deposits, Cost of equity, Cost of retained earnings and Cost of depreciation funds are the four major capital structure components and costs\textsuperscript{59}

2.13.1 Cost of Deposits

It means the rate of return that must be earned on debt financed investment in order to keep unchanged the earnings available to equity shareholders.

2.13.2 Cost of Equity Shares

As owners of the firm, the ordinary shareholders bear the greater risk. If the bank operates unsuccessfully, the shareholders are the first to suffer in terms of dividends and probably fall in the market value of their shares. In short, it means the minimum rate of return that the bank must earn on the equity financed proportion of an investment project or to leave unchanged the market price of the existing stock

2.13.3 Cost of Retained Earnings

Retained earnings are undistributed profits. The banks are not required to pay any dividend on retained earnings. In fact retained profits are a very important source of finance, accounting for over half of all the long-term finance raised by banks over recent years. Therefore, it is sometimes regarded as the cost free source of finance.

2.13.4 Cost of Depreciation Funds

Depreciation funds are also used by the banks. Depreciation funds appear to be cost less but this not so. Their costs too, like cost of retained earnings, are calculated on the basis of opportunity cost to the shareholders.

2.14 Capital Structure

The capital structure of a bank refers to the mix of the long-term finances used by the bank. It is the financing plan of the bank. The objective of any bank is to mix the permanent sources of funds used by it in a manner that will maximize the bank's market price. In other words banks seek to minimize their cost of capital. This proper mix of funds is referred to as the Optimal Capital Structure. The capital structure
decision is a significant managerial decision which influences the risk and return of the investors. The bank will have to plan its capital structure at the time of promotion itself and also subsequently whenever it has to raise additional funds for various new projects. Wherever the bank needs to raise finance, it involves a capital structure decision because it has to decide the amount of finance to be raised as well as the source from which it is to be raised. The use of fixed charges sources of funds such as deposits, loans from other banks along with equity capital in the capital structure is described as financial leverage or trading on equity. The term trading on equity is used because it is the equity that is used as a basis for raising debt. Increased use of leverage increases the fixed commitments of the bank in the form of interest and repayments and thus increases the risk of the equity shareholders as their returns are affected. Profitability, Flexibility, Control and Solvency are the features of an optimal capital structure.\footnote{Dr. S N Maheshwari. \textit{Financial Management Principles and Practice} (New Delhi: Sultan Chand & sons, 2000) 312.}
2.15 Working Capital Management

Working capital is defined as the excess of current assets over current liabilities. It represents the investment of a bank’s funds in assets which are expected to be raised within a short period of time. However the requirements of current assets are usually greater than the amount of funds available through current liabilities. The bank’s working capital may be viewed as being comprised of two components. Permanent working capital represents the current assets required on a continuing basis over the entire year. It represents the amount of cash and receivables, to carry on operations at any time, as safe measure. Additional assets required at different times during the operating year are termed as variable working capital.

2.16 Need for Working Capital

Need for funds arise due to the increase in the level of banking business activities. Similarly if surplus funds arise then it should be invested in

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short-term securities. The need for working capital to run the day-to-day banking business activities cannot be overemphasised. Indeed, banks differ in their requirements of the working capital. In its endeavor to maximise shareholder’ wealth, a bank should earn sufficient return from its operations. There is always an operating cycle involved in the conversion of advances into cash. It is clear that working capital is required because of the time gap between the advances and their actual realization in cash. This time gap is technically termed as “operating cycle” of the bank.

2.17 Adequacy of Working Capital

Sound working capital position is necessary to run banking business operations smoothly and profitably. A concern needs funds for its day-to-day running. Adequacy or inadequacy of these funds would determine the efficiency with which the daily banking business may be carried on. Management of working capital is an essential task of the finance manager. He has to ensure that the amount of working capital available with his concern is neither too large nor too small for its requirements. A very big amount of working capital would mean that the bank has idle funds. Since funds have a cost, the bank has to pay large amounts as
interest on such funds. If the bank has inadequate working capital, it is said to be under-capitalised. Such a bank runs the risk of insolvency. This is because paucity of working capital may lead to a situation where the bank may not be able to meet its liabilities.

2.18 Determinants of Working Capital

In order to determine the proper amount of working capital of the concern, the following factors should be considered

2.18.1 Size of Banks

Working capital requirements of a bank are basically influenced by the size of its business. Banks have a very small investment in fixed assets, but require a large sum of money to be invested in working capital. Size may be measured in terms of the scale of operation. A bank with larger scale of operation will need more working capital than a small bank.

2.18.2 Advance Growth

The working capital needs of the bank increase as its advance grow. It is difficult to precisely determine the relationship between volume of advances and working capital needs. In practice, current assets will have to be employed before growth takes place. It is, therefore, necessary to
make advance planning of working capital for a growing bank on a continuous basis.

2.18.3 Advance Conditions

Most banks experience seasonal and cyclical fluctuations in the demand for their advances. These banking business variations affect the working capital requirement, specially the temporary working capital requirement of the bank. When there is an upward swing in the economy, advances will increase.

2.18.4 Interest Rate Fluctuations

The increasing shifts in interest rate fluctuations make the function of the financial manager difficult. He should anticipate the effect of interest rate changes on working capital requirements of the bank. Generally, rising levels will require a bank to maintain higher amount of working capital.
2.18.5 Operating Efficiency and Performance

The operating efficiency of the bank relates to the optimum utilisation of resources at minimum costs. The bank will be effectively contributing to its working capital if it is efficient in controlling operating costs. The use of working capital is improved and pace of cash cycle is accelerated with operating efficiency. Better utilisation of resources improves profitability and, thus, helps in releasing the pressure on working capital.

2.18.6 Bank’s Credit Policy

The credit policy of the banks affects the working capital by influencing the level of book debts. The bank should be discretionary in granting credit terms to its customers. Depending upon the individual case, different terms may be given to different customers. A liberal credit policy, without rating the credit-worthiness of customers, will be detrimental to the bank and will create a problem of collecting funds later on. In order to ensure that necessary funds are not tied up in book debts, the bank should follow a rationalised credit policy based on the credit standing of customers and other relevant factors.  

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2.19 Management of Cash

Cash is the most important current asset for the operations of the banking business. Cash is the basic input needed to keep the banking business running on a continuous basis. It is also the ultimate output expected to be realized by selling the service by the bank. The bank should keep sufficient cash, neither more nor less. Cash shortage will disrupt the banking operation while excessive cash will simply remain idle, without contributing anything towards the bank’s profitability. Thus, a major function of the financial manager is to maintain a sound cash position. Cash is the money which a bank can disburse immediately without any restriction. The term cash includes coins, currency and cheques held by the firm, and balances in its accounts.

2.20 Problems of Cash management

Fig-F 3 shows the four basic problems involving the cash management.64

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2.20.1 **Controlling Levels of Cash**

One of the basic objectives of cash management is to minimise the levels of cash balance of the bank. This objective is sought to be achieved by means of some factors such as preparing cash budget, providing for unpredictable discrepancies, consideration of short costs and availability of other sources of funds.
2.20.2 Controlling Inflows of Cash

Having prepared the cash budget, the finance manager should also ensure that there is no sufficient deviation between the projected cash inflows and the projected cash out flows. This requires controlling of both inflows as well as out flows of cash.

2.20.3 Controlling Outflows of Cash

An effective control over cash outflows or disbursements also helps a bank in conserving cash and reducing financial requirements.

2.20.4 Optimum Investment of Surplus Cash

There are two basic problems regarding the investment of surplus cash such as determination of surplus cash and determination of the channels of investments. Surplus cash is the cash in excess of the bank’s normal cash requirements. While determining the amount of surplus cash, the finance manager has to take into account the minimum cash balance that the bank must keep to avoid risk or cost of running out of funds. Such surplus cash may be either of a temporary or permanent nature. In most of the banks there are usually no formal written instruments for investing
the surplus cash. It is left to the discretion and judgment of the finance manager.

2.21 Motives for Holding Cash

Motives for holding cash by the banks are depicted in Fig-F 4

![Motives for Holding Cash](image)

**Fig. F 4:** Motives for Holding Cash

2.21.1 Transaction Motive

The transaction motive requires a bank to hold cash to conduct its business in the ordinary course. The bank needs cash primarily to make payments for advances, wages and salaries, other operating expenses, taxes, dividends etc. The need to hold cash would not arise if there were perfect synchronization between cash receipts and cash payments, i.e. enough cash is received when the payment has to be made. But cash receipts and payments are not perfectly synchronized. For those periods,
when cash payments exceed cash receipts, the bank should maintain some cash balance to be able to make the required payments. For transactions purpose a bank may invest its cash in marketable securities. Usually, the bank will purchase securities whose maturity corresponds with some anticipated payments, such as dividends, or taxes in future. Notice that the transactions motive mainly refers to holding cash to meet anticipated payments whose timing is not perfectly matched with cash receipts.

2.21.2 Precautionary Motive

The precautionary motive needs to hold cash to meet contingencies in future. It provides a cushion or buffer to withstand some unexpected emergency. The precautionary amount of cash depends upon the predictability of cash flows. If cash flows can be predicted with accuracy, less cash will be maintained for an emergency. The amount of precautionary cash is also influenced by the bank’s ability to borrow at short notice when the need arises. The precautionary balance may be kept in cash and marketable securities. Marketable securities play an important role here.
2.21.3 Speculative Motive

Some firms may hold cash for speculative purposes. By and large, banking business firms do not engage in speculations. Thus, the primary motive to hold cash and marketable securities are the transactions and the precautionary motive. Cash planning is a technique to plan and control the use of cash. It protects the financial condition of the bank by developing a projected cash statement through a forecast of expected cash inflows and outflows for a given period. The forecasts may be based on the present operations or the anticipated future operations. Cash plans are very crucial in developing the overall operating plans of the bank.65

2.22 Management of Accounts Receivable

Accounts receivable constitute a significant portion of the total current assets of the banking business. Receivables are asset accounts representing amounts owned to the bank as a result of sale of services in the ordinary course of banking business.66 It represents the claims of a

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bank against its customers and is carried to the “assets side” of the balance sheet under titles such as accounts receivable, customer receivables or book debts.

2.23 Capital Budgeting

The term capital budgeting refers to the long term planning for proposed capital outlays and their financing. Thus, it includes both raising of long term funds as well as their utilization. It may thus be defined as “the bank’s formal process for the acquisition and investment of capital”.

Capital Budgeting projects, i.e., potential long-term investments, are expected to generate cash flows over several years. The decision to accept or reject a capital budgeting project depends on an analysis of the cash flows generated by the project and its cost.

2.24 Techniques of Capital Budgeting

The most commonly used techniques of capital budgeting are shown in the Fig-F 5 given below.

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2.24.1 Pay Back Period

The payback method simply measures how long it takes to recover the initial investment. This method is suitable for banks of fast technological and market changes, political instability, and scarcity of capital. The maximum acceptable payback period is determined by the management. If the payback period is less than the maximum acceptable payback period, they accept the project. If the payback period is greater than the maximum acceptable payback period, they reject the project. The project having the lowest pay back period is selected in mutually exclusive projects.
### 2.24.2 Average Rate of Return

According to this method, the capital investment proposals are judged on the basis of their relative profitability. For this purpose, the capital employed and the related income are determined according to commonly accepted accounting principles and practices over the entire economic life of the project and then the average yield is calculated. Such a rate is termed as the average rate of return.

### 2.24.3 Net Present Value

Net Present Value is found by subtracting the present value of the after-tax outflows from the present value of the after-tax inflows. In case the NPV is positive the project should be accepted and vice versa.

### 2.24.4 Internal Rate of Return

Internal rate of return is that rate at which the sum of discounted cash inflows equals the sum of discounted cash outflows. In other words, it is the rate which discounts the cash flows to zero.\(^6\)

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2.25 Leverage

James Horne has defined leverage as “the employment of an asset or funds for which the firm pays a fixed cost or fixed return”\textsuperscript{70} The term leverage is generally used to utilize the fixed cost assets or funds to increase the return to the owners of the bank. There are two types of leverages, i.e., Operating leverage and financial leverage. The operating leverage may be defined as the tendency of the operating profit to vary disproportionately with income. The bank is said to have a high degree of operating leverage if it employs a greater amount of fixed cost and a small amount of variable cost. On the other hand, a bank will have a low operating leverage when it employs a greater amount of variable cost and smaller amount of fixed cost. The financial leverage may be defined as the tendency of the residual net income to vary disproportionately with operating profit. The use of fixed interest / dividend bearing securities such as deposits, loans from other banks along with the owner’s equity in the total capital structure of the company is described as financial leverage.\textsuperscript{71}


2.26 Financial Statement Analysis

The financial statement analysis is a study of the relationship among the various financial factors in a business as disclosed by a single set of statements and a study of the trend of these factors as shown in a series of statements. The analysis of the financial requires

- Methodical classification of data given in financial statements
- Comparison of the various inter-connected figures with each other by different ‘Tools of Financial Analysis’.

The financial analyst can adopt one or more of the following techniques/tools of financial analysis Fig-F 6:

**Fig. F 6 : Financial Analysis Techniques**
2.27 Ratio Analysis

Today’s competitive environment in which the commercial banks operate, demands high levels of performance efficiency. Added to the intense competition, all the banks are increasingly subjected to severe regulatory and prudential measures that are indented to ensure the viability and sustenance of the business as well as the safety of its stakeholders. In this context, analysis of financial performance to gauge the effectiveness of the managerial practices followed gains significance.

Ratio analysis is one of the techniques of financial analysis where ratios are used as a yardstick for evaluating the financial condition and performance of a bank. Analysis and interpretation of various accounting ratios give a skilled and experienced analyst a better understanding of the financial condition and performance of the bank.

2.28 Classification of Ratios

Analysis and interpretation of financial statements are classified in Fig-F 7 given below.\textsuperscript{72}

2.28.1 Profitability Ratios

Profitability analysis can be done by employing a variety of ratios, depending on the nature and the objective of analysis. Apart from the short-term and the long-term creditors, the management of a bank is also interested in its financial soundness, particularly the operating efficiency, which can be judged only by the profitability of the bank. The importance of profit for a bank cannot be over-emphasized, since profit is the ultimate test of management effectiveness. Profitability ratios are the indication of the efficiency with which the operations of the banking business are carried on. The following Fig-F 8 shows the important profitability ratios.\(^{73}\)

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2.28.1.1 Overall Profitability Ratio

The management is constantly concerned about the overall profitability of the enterprise, its ability to meet short-term as well as long-term
obligations to its creditors, besides ensuring a reasonable return to its
owners and securing optimum utilisation of assets. The overall
profitability ratio indicates the percentage of return on the total capital
employed in the banking business.

2.28.1.1.1 Return on Shareholders Funds

Return on shareholders funds ratio indicates how profitable the
shareholder’s funds have been utilised by the enterprise. The ratio can be
compared with that of other banks engaged in similar activities. It is the
profitability of the bank from the shareholder’s point of view.

2.28.1.1.2 Return on Equity Shareholders Funds

Return on shareholders funds is considered to be an important ratio to
determine whether there has been a satisfactory return for the equity
shareholders. The adequacy or otherwise of the rate of return could be
judged by comparing it with that of the earlier years, by inter-firm
comparison and by comparison with the industry average. The
profitability from the point of view of the equity shareholders will be
judged after taking into account of dividend payable to the preference
shareholders.
2.28.1.1.3 Return on Total Assets

Return on total assets comprises of net fixed assets (i.e., fixed assets less accumulated depreciation) and net working capital (i.e., current assets minus current liabilities), but excludes intangible assets, fictitious assets, idle/unused assets, obsolete stocks, doubtful debts etc. This ratio is computed to know the productivity of total assets.

2.28.1.1.4 Return on Gross Capital Employed

Return on capital employed gives an insight into how efficiently the long term funds of the owners and creditors are used. The higher the ratio, the more efficient is the use of capital employed. The term gross capital employed means the total of fixed assets and the current assets employed in the banking business.

2.28.1.2 Earning Per Share

Earning per share indicates the quantum of net profit of the year that would be ranking for dividend for each share of the company being held by the equity share holders. In order to avoid confusion on account of
the varied meanings of the term capital employed, the overall profitability can be judged by calculating earning per share. \(^74\)

### 2.28.1.3 Price Earning Ratio

This ratio indicates the number of times the earning per share is covered by its market price.

### 2.28.1.4 Net Profit Ratio

This ratio measures the overall efficiency of production, administration, selling, financing, pricing and tax management of an enterprise. The ratio is, therefore indicative of the management’s ability to operate the banks with success, by way of recovery from revenues.

### 2.28.1.5 Operating Ratio

This ratio is a complementary of net profit ratio. In case the net profit ratio is 20%, the operating ratio is 80%.

### 2.28.1.6 Pay out Ratio

This ratio indicates what proportion of earning per share has been used for paying dividend.

2.28.1.7 Dividend Yield Ratio

This ratio is particularly useful for those investors who are interested only in dividend income.

2.28.2 Coverage Ratio

These ratios indicate the extent to which the interests of the persons entitled to get a fixed return (interest or dividend, as the case may be) or a scheduled repayment as per the agreed terms, are safe. The higher the cover the better it is. The following figure Fig-F 9 shows the important coverage ratios:75

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2.28.2.1 Fixed Interest Cover

This ratio is very important from the lender’s point of view. It indicates whether the business would earn sufficient profits to pay periodically the interest charges.

2.28.2.2 Fixed Dividend Cover

This ratio is important for preference shareholders entitled to get dividend at a fixed rate in priority to other share holders.

2.28.3 Turnover Ratios

Turn over ratio indicates the efficiency with which the capital employed is rotated in the banks. The overall profitability of the banks depends on two factors viz., the rate of return on capital employed and the turn over.\(^{76}\) The following figure Fig-F 10 shows the important turnover ratios:\(^{77}\)

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2.28.3.1 Fixed Asset Turn Over Ratio

This ratio indicates the extend to which the investments in fixed assets contribute towards income.

2.28.3.2 Working Capital Turnover Ratio

Working capital turn over ratio indicates whether or not the working capital has been effectively utilised in making income. In case a banking business can achieve higher volume of income with relatively small amount of working capital, it is an indication of the operating efficiency of the bank.
2.28.4 Financial Ratios

Financial ratios indicate about the financial position of the bank. A bank is deemed to be financially sound if it is in a position to carry on its business smoothly and meet its obligations, both short-term as well as long-term, without financial strain. It is a sound principle of finance that the short-term requirements of funds should be met out of the short-term funds and long-term requirements should be met out of the long-term funds. The following figure Fig-F 11 shows the important financial ratios.

Fig. F 11: Financial Ratios

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2.28.4.1 Liquidity Ratios

A bank must have adequate working capital to run its day-to-day operations. Inadequacy of working capital may bring the entire banking business operation to a grinding halt because of its inability to pay for advances, wages and other regular expenses.

2.28.4.1.1 Current Ratio

This ratio is an indicator of the bank’s commitment to meet its short-term liabilities. Current ratio is ascertained by comparing the current assets to current liabilities.

2.28.4.1.2 Quick Ratio

Quick ratio is ascertained by comparing the liquid assets to current liabilities.

2.28.4.2 Stability ratios

These ratios help in ascertaining the long term profitability of a bank which depends basically on three factors viz., whether the bank has adequate resources to meet its long term funds requirements, whether the bank has used an appropriate debt-equity ratio mix to raise long-funds
and whether the bank earns enough to pay interest and installment of long term loans in time.

**2.28.4.2.1 Fixed Assets Ratio**

This ratio explains whether the bank has raised adequate long-term funds to meet its fixed assets requirements.

**2.28.4.2.2 Capital Structure Ratios**

Capital structure ratios explain how the capital structure of a bank is made up or the debt-equity mix adopted by the bank.

**2.28.4.2.3 Capital Gearing Ratio**

Capital gearing refers to the proportion between fixed interest or dividend bearing funds and non-fixed interest or dividend bearing funds in the total capital employed in the banks.

**2.28.4.2.4 Debt Equity Ratio**

The debt-equity ratio is determined to ascertain the soundness of the long term financial policies of the bank. It indicates the proportion of
owner’s stake in the banks and also the extent to which the firm depends upon the outsiders for its existence.

2.28.4.2.5 Proprietary Ratio

This ratio focuses attention on the general financial strength of the banks. The ratio is of particular importance to the creditors who can find out the proportion of shareholder’s funds in the total assets in the banks. It establishes the relationship between the proprietor’s funds and the total tangible assets.

2.29 Financial Management and Banks

The symbiotic relationship between financial management and banks is represented in the figure Fig-F 12 below: 2
SYMBIOTISM

**Fig. F 12:** Financial Management and Banks
BANKING

2.30 Bank

The name bank derives from the Italian word *banco*. A bank is a financial institution licensed by a government. Its primary activities include borrowing and lending money. Banks borrow money by accepting funds deposited on current account, accepting term deposits and by issuing debt securities such as banknotes and bonds. Banks lend money by making advances to customers on current account, by making installment loans, and by investing in marketable debt securities and other forms of lending. Banks provide almost all payment services, and a bank account is considered indispensable by most businesses, individuals and governments. The definition of a bank varies from country to country. Under English law, a bank is defined as a person who carries on the business of banking, which is specified as: 79

1. Conducting current accounts for his customers
2. Paying cheques drawn on him, and
3. Collecting cheques for his customers.

Banking companies in India are governed by the Banking Regulation Act, 1949. Section 5 of the Act defines banking as “the accepting, for the purpose of lending or investment, of deposits of money from the public payable on demand or otherwise and withdrawable by cheque, draft, order or otherwise”.

2.31 History of World Banking

The history of banking is closely related to the history of money. Monetary payments are important because, people looked for ways to safely store their money. As trade grew, merchants looked for ways of borrowing money to fund expeditions.

2.31.1 The Early History

The first banks were probably the religious temples of the ancient world, and were probably established sometime during the 3rd millennium B.C. There are extant records of loans from the 18th century BC in Babylon that were made by temple priests and monks to merchants. Ancient Greece holds further evidence of banking. Greek temples, as well as

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private and civic entities, conducted financial transactions such as loans, deposits, currency exchange, and validation of coinage.\textsuperscript{81}

The fourth century B.C. saw increased use of credit-based banking in the Mediterranean world. Ancient Rome perfected the administrative aspect of banking. Charging interest on loans and paying interest on deposits became more highly developed and competitive. The development of Roman banks was limited, however, by the Roman preference for cash transactions. After the fall of Rome, banking was abandoned in Western Europe and did not revive until the time of the Crusades.\textsuperscript{82}

By 1200 there was a large and growing volume of long distance and international trade in a number of agricultural commodities and manufactured goods in Western Europe. The need to transfer large sums of money to finance the Crusades stimulated the reemergence of banking in Western Europe.\textsuperscript{83}


2.31.2 Western Banking History

Modern Western economic and financial history is usually traced back to the coffee houses of London. The London Royal Exchange was established in 1565. In 1609 the Amsterdamsche Wisselbank (Amsterdam Exchange Bank) was founded which made Amsterdam the financial centre of the world until the Revolution. Banking offices were usually located near centers of trade, and in the late 17th century, the largest centers for commerce were the ports of Amsterdam, London, and Hamburg. Around the time of Adam Smith (1776) there was a massive growth in the banking industry. Within the new system of ownership and investment, the State's intervention in economic affairs was reduced and barriers to competition were removed.

By the early 1900s New York was beginning to emerge as a world financial centre. Companies and individuals acquired large investments in companies in the US and Europe, resulting in the first true market integration.

The stock market crash in 1929 was a global event. Market crashed everywhere, all at the same time, and the volume of foreign selling orders was high. The Great Depression followed, and the banks were
blamed for it, although the evidence has never been strong to connect the speculative activities of the banks during the 1920s with either the crash or the subsequent depression of the 1930s.\textsuperscript{84} Nonetheless, there were three prominent results from these events that had great effect on American banking. The first was the passage of the Banking Act of 1933 that provided for the Federal Deposit Insurance system and the Glass–Steagall provisions that completely separated commercial banking and securities activities. Second was the depression itself, which led in the end to World War II and a 30-year period in which banking was confined to the basic- slow-growing, deposit taking and loan making within a limited local market only. And the third was the rising importance of the government in deciding financial matters, especially during the post-war recovery period. As a consequence, there was comparatively little for banks or securities firms to do from the early 1930s until the early 1960s.\textsuperscript{85}


2.31.3 Global Banking

In the 1970s, a number of smaller crashes tied to the policies put in place following the depression, resulted in deregulation and privatisation of government-owned enterprises in the 1980s, indicating that governments of industrial countries around the world found private-sector solutions to problems of economic growth and development preferable to state-operated, semi-socialist programs. This spurred a trend that was already prevalent in the business sector, large companies becoming global and dealing with customers, suppliers, manufacturing, and information centers all over the world.\textsuperscript{86}

Global banking and capital market services proliferated during the 1980s and 1990s as a result of a great increase in demand from companies, governments, and financial institutions, but also because financial market conditions were buoyant and, on the whole, bullish.\textsuperscript{87}

Nevertheless, in recent years, the dominance of U.S. financial markets has been disappearing and there has been an increasing interest in


\textsuperscript{87} India Reserve Bank. \textit{Statistical Tables Relating to Banks in India} (New Delhi: Reserve Bank of India, 1999) 756.
foreign stocks. The extraordinary growth of foreign financial markets results from both large increases in the pool of savings in foreign countries, such as Japan, and, especially, the deregulation of foreign financial markets, which has enabled them to expand their activities. Thus, American corporations and banks have started seeking investment opportunities abroad, prompting the development in the U.S. of mutual funds specializing in trading in foreign stock markets.

Such growing internationalization and opportunity in financial services has entirely changed the competitive landscape, as now many banks have demonstrated a preference for the “universal banking” model so prevalent in Europe. Universal banks are free to engage in all forms of financial services, make investments in client companies, and function as much as possible as a “one-stop” supplier of both retail and wholesale financial services.

This growth and opportunity also led to an unexpected outcome: entrance into the market of other financial intermediaries: non banks. Large corporate players were beginning to find their way into the financial service community, offering competition to established banks. The main services offered included insurances, pension, mutual funds,
money market and hedge funds, loans and credits and securities. Indeed, by the end of 2001 the market capitalisation of the world’s 15 largest financial services providers included four non banks.88

In recent years, the process of financial innovation has advanced enormously, increasing the importance and profitability of non bank finance. Such profitability previously restricted to the non banking industry, has prompted the Office of the Comptroller of the Currency (OCC) to encourage banks to explore other financial instruments, diversifying bank’s business as well as improving banking economic health. Hence, the distinct financial instruments are being explored and adopted by both the banking and non banking industries, the distinction between different financial institutions are gradually vanishing.

2.32 History of Banking in India

Banking in India originated in the first decade of 18th century with The General Bank of India coming into existence in 178689. From 1786 till


today, the journey of Indian Banking System can be segregated into three distinct phases. They are as mentioned below:

- Early phase from 1786 to 1969 of Indian Banks
- Nationalisation of Indian Banks and up to 1991 prior to Indian banking sector Reforms.
- New phase of Indian Banking System with the advent of Indian Financial & Banking Sector Reforms after 1991

2.32.1 The Early phase

The General Bank of India was set up in the year 1786. This was followed by Bank of Hindustan and Bengal Bank. The East India Company established Bank of Bengal (1809), Bank of Bombay (1840) and Bank of Madras (1843) as independent units and called it Presidency Banks. These three banks were amalgamated in 1920 and Imperial Bank of India was established which started as private shareholders banks, mostly European shareholders.\(^9\)

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In 1865 Allahabad Bank was established. The Punjab National Bank Ltd. was set up in 1894 exclusively by Indians with headquarters at Lahore. Between 1906 and 1913, Bank of India, Central Bank of India, Bank of Baroda, Canara Bank, Indian Bank, and Bank of Mysore were set up. Reserve Bank of India came in 1935. During the first phase the growth was very slow and banks also experienced periodic failures between 1913 and 1948. There were approximately 1100 banks, mostly small. To streamline the functioning and activities of commercial banks, the Government of India came up with certain measures.

1. In 1948, the Reserve Bank of India, India's central banking authority, was nationalized, and it became an institution owned by the Government of India.

2. In 1949, the Banking Regulation Act was enacted which empowered the Reserve Bank of India (RBI) "to regulate, control, and inspect the banks in India."

3. The Banking Regulation Act also provided that no new bank or branch of an existing bank may be opened without a license from the RBI, and no two banks could have common directors.
However, despite these provisions, control and regulations, banks in India except the State Bank of India, continued to be owned and operated by private persons. This changed with the nationalization of major banks in India on 19th July, 1969.91

2.32.2 Nationalisation

By the 1960s, the Indian banking industry had become an important tool to facilitate the development of the Indian economy. At the same time, it had emerged as a large employer, and a debate had ensued about the possibility to nationalize the banking industry.92 The nationalisation of banks in India took place in 1969 by Mrs. Indira Gandhi, the then prime minister. It nationalised 14 banks then. A second dose of nationalisation of 6 more commercial banks followed in 1980. The stated reason for the nationalisation was to give the government more control of credit delivery. With the second dose of nationalisation, the GOI controlled around 91% of the banking business of India. After this, until the 1990s, the nationalised banks grew at a pace of around 4%, closer to the


average growth rate of the Indian economy. Banking in the sunshine of Government ownership gave the public implicit faith and immense confidence about the sustainability of these institutions.

2.32.3 Liberalisation

In the early 1990s, the then Narsimha Rao government embarked on a policy of liberalisation and gave licenses to a small number of private banks, which came to be known as New Generation tech-savvy banks, which included banks such as Global Trust Bank (the first of such new generation banks to be set up) which later amalgamated with Oriental Bank of Commerce, UTI Bank (now re-named as Axis Bank), ICICI Bank and HDFC Bank. This move, along with the rapid growth in the economy of India, kick started the banking sector in India, which has seen rapid growth with strong contribution from all the three sectors of banks, namely, government banks, private banks and foreign banks.

2.32.4 Current Situation

The financial system of India has shown a great deal of resilience. It is sheltered from any crisis triggered by any external macroeconomics shock as other East Asian Countries suffered. This is all due to factors
like flexible exchange rate regime, high foreign reserves, not yet fully convertible capital account, and limited foreign exchange exposure. For the past three decades India's banking system has several outstanding achievements to its credit. The most striking is its extensive reach. It is no longer confined to only metropolitans or cosmopolitans in India. In fact, Indian banking system has reached even to the remote corners of the country. This is one of the main reasons of India's growth process.

The Indian financial system is regulated and supervised by two government agencies under the Ministry of Finance, namely, the Reserve Bank of India and the Securities and Exchange Board of India (SEBI). Currently, banking in India is fairly mature in terms of supply and product range. In terms of quality of assets and capital adequacy, Indian banks are considered to have clean, strong and transparent balance sheets relative to other banks in comparable economies in its region. The Reserve Bank of India is an autonomous body, with minimal pressure from the government. The stated policy of the Bank on the Indian Rupee is to manage volatility but without any fixed exchange rate-and this has mostly been true.
Currently, India has 88 scheduled commercial banks (SCBs) - 28 public sector banks (that is, with the Government of India holding a stake), 29 private banks (these do not have government stake; they may be publicly listed and traded on stock exchanges) and 31 foreign banks. They have a combined network of over 53,000 branches and 17,000 ATMs. According to a report by ICRA Limited, a rating agency, the public sector banks hold over 75 percent of total assets of the banking industry, with the private and foreign banks holding 18.2% and 6.5% respectively.  

2.33 Scheduled Banks Registered in the State of Kerala  

2.33.1 The Federal Bank Limited  

The Federal Bank, the largest traditional private sector bank in the country is headquartered at Aluva, Kerala. The bank was established by Kulangara Paulo Hormis. The Federal Bank, flourishing for more than seven decades has gained the reputation of being an agile, technology savvy and customer friendly bank. It built a wide network of

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branches, reaching out to cover all the major cities of the country, to be accepted as one of the leading private sector banks in the country. Federal Bank has played a pioneer role in developing and deploying new technology assisted customer friendly products and services.

The Federal Bank Limited (the erstwhile Travancore Federal Bank Limited) was incorporated with an authorised capital of rupees five thousand at Nedumpuram, a place near Tiruvalla in Central Travancore on 28-4-1931 under the Travancore Company's Act. It started business of auction-chitty and other banking transactions connected with agriculture and industry. The bank though successful in the earlier periods, suffered set backs and was on the verge of liquidation.

In 1945 Mr. K P Hormis took up the reins of Federal Bank as its Chief Executive. Fired by a passion for institution building, Shri Hormis built out of a One-Branch-Small-Time Bank, a nationwide institution of 285 branches in the 34 years that he remained at the helm. The quintessential banker that he was, he much before these areas came into national focus laid a structure for extending finance to agriculture and the weaker sections of society. The strength of the Bank today in terms of national
presence, diversified clientele, skilled and dedicated manpower and profitable operations, owes a great deal to the vision of this great man.

The bank became a scheduled commercial bank in 1970, which also coincided with the silver jubilee year, since the bank commenced its operation in Aluva. The bank’s approach towards the Industrial Finance is reflected in its emblem- Farmer in action enriched by an industrial wheel.

The Federal Bank is the first among the traditional banks to have all its branches automated and has attained 100% connectivity. The bank is also the forerunner in introducing Internet Banking Service through Fed Net. The Federal Bank also pioneered among the traditional banks in Electric Telephone bill payment, E-Shopping payment gate way, mobile Alerts and mobile Banking service, Express remittance Facility from abroad and in providing RTGS facility in all its branches.

The Bank has also the distinction of being one of the first banks in the country to deploy most of these technology enabled services at the smaller branches including rural and semi-urban areas.\(^{94}\)

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2.33.2 The South Indian Bank Limited

One of the earliest banks in South India, “South Indian Bank” came into being during the Swadeshi movement. The establishment of the bank was the fulfillment of the dreams of a group of enterprising men who joined together at Thrissur, in the erstwhile State of Cochin to provide for the people a safe, efficient and service oriented repository of savings of the community on one hand and to free the business community from the clutches of greedy money lenders on the other by providing need based credit at reasonable rates of interest.

Translating the vision of the founding fathers as its corporate mission, the bank has during its long sojourn been able to project itself as a vibrant, fast growing, service oriented and trend setting financial intermediary. It is the first among the private sector banks in Kerala to become a scheduled bank in 1946 under the RBI Act.

The bank also pioneered among the private sector banks in Kerala in opening a Currency Chest on behalf of the RBI in April 1992, a NRI branch in November 1992, an Industrial Finance Branch in March 1993,
an "Overseas Branch" to cater exclusively to the export and import business in June 1993, to develop an in-house, fully integrated branch automation software in addition to the in-house partial automation solution operational since 1992. The South Indian Bank is the first Kerala based bank to implement the Core Banking System. It is the third largest branch network among Private Sector banks, in India, with all its branches under Core banking System. Now the bank has 549 branches, 9 extension counters and 304 ATM counters.95

2.33.3 The Catholic Syrian Bank Limited

The genesis of Indian Banking is associated to a large extent with Swadeshi Movement, which inspired many Indians to promote Swadeshi Banks in the beginning of the 20th Century. The enterprising founders of Catholic Syrian Bank Ltd also found this period to be a moment of opportunity to promote the establishment of a bank. Thus was born The Catholic Syrian Bank Ltd, on 26th November, 1920 exact at Thrissur,

which in later years acquired the unique distinction of being a centre with the highest concentration of banks in the South. The founder directors of the bank were people of eminence known for their foresight, integrity and initiative. The policy they laid down has been consistently upheld by the successive generations who guided the destiny of the institution. The bank commenced business on January 1st, 1921 with an authorised capital of Rs.5 lakhs and a paid up capital of Rs.45270.

During the first two decades of its functioning, the Bank concentrated only in Kerala. Banks and credit institutions, which proliferated especially in Kerala, received a jolt and many of them came to their doom following the crash of the Travancore National Quilon Bank in 1938 followed by Palai Central Bank in 1960. During the period many small banks came to the verge of collapse shaking the confidence of the public and what followed was a process of consolidation. The strategy of mergers and amalgamations of small banks with bigger banks brought the number of banks within controllable limits, thereby making the industry's base strong. In 1964-65, The Catholic Syrian Bank Ltd took part in taking over the liabilities and assets of five small/medium sized
banks in Kerala. The expansion programme initiated during these years gathered momentum in the subsequent years.

In August 1969, the Bank was included in the Second Schedule of the Reserve Bank of India Act 1934. In 1975, the Bank attained the status of "A" Class Scheduled Bank when its total Deposits crossed Rs.25 crores.

Now the bank has 363 branches, 1 extension counter and 123 ATM counters.\(^96\)

2.33.4 The Dhanalakshmi Bank Limited

The Dhanalakshmi Bank was incorporated on 14th November 1927 by a group of enterprising entrepreneurs at Thrissur, the cultural capital of Kerala with a Capital of Rs.11000 and 7 employees. It became a Scheduled Commercial Bank in the year 1977. It has today attained national stature with 181 branches and 26 Extension Counters spread over the States of Kerala, Tamil Nadu, Karnataka, Andhra Pradesh, Maharashtra, Gujarat, Delhi and West Bengal. The Bank serviced a business of over Rs.5770 crores as on 31.03.2008 comprising deposits of

Rs.3608 crores and advances of Rs.2164 crores. The Bank made a net profit of Rs.28.46 crores for the year ended 31st March 2008.

The Bank lays stress on customizing services and personalizing relations. It has introduced an International Debit Card through a tie-up with M/s Visa International. As part of this overall effort, the Bank has joined CASHNET, the first independent nation-wide shared ATM network in India, the National Financial Switch (ATM network) of the IDRBT, promoted by Reserve Bank of India and Cash tree promoted by a group of public sector banks.

The Bank has ventured into both life and non-life insurance. It is selling life insurance products of M/s. MetLife India, a renowned global player in this segment and non-life insurance products of M/s. Iffco Tokio, as their corporate agent. The Bank is also a depository participant of NSDL (National Security Depository Limited) offering De-mat services through selected branches.

With a view to make available value-added services to the NRIs, the Bank has set up NRI Boutiques (Relationship Centers) at 9 locations in the State of Kerala and Tamil Nadu. The Bank has also plans to open specialized NRI branches with accent on quality of service and thrust on
specialisation at potential locations. As at the end of March 2008, the Bank had rupee drawing arrangements with 8 Exchange Houses in the Middle East. For fast money transfer, it has tied up with UAE Exchange & Financial Services for Xpress Money and Moneygram, Wall Street Finance for Wall Street instant cash and Indusind Bank Limited for Zoha Inc. the Bank has also tied up with SBI Mutual Fund for selling their products.  

The Bank’s Corporate Office, Thrissur and Industrial Finance Branch at Kochi have been accredited with certification under ISO 9001-2000.

On the socio-economic front, the Bank is a leading player in dispensation of Micro Credit among Kerala-based Private Sector Banks. As at the end of March 2008, the out standings under micro credit were Rs.92.08 crores. This involvement is part of the Bank’s objective to act as catalysts for the economic prosperity of the country. The Bank has recognized micro finance intervention as an effective tool for poverty alleviation and has streamlined the linkage between the Bank and Self Help Groups through 121 branches. The Priority sector advances of the

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Bank as at 31st March 2008 constituted 51.24% of net bank credit well above the RBI benchmark of 40%. Agricultural advance as a percentage of Net Bank Credit was 19.08% as against the RBI norm of 18%.

2.33.5 The Lord Krishna Bank Limited

The year was 1940. In a quaint little hamlet called Kodungallur in Trichur district of Kerala, a humble initiative was taken, to serve the people of the region with honesty, commitment and dynamism. And thus was born Lord Krishna Bank. When the seeds of expansion were sown in the 60s 3 commercial banks merged with LKB. The turning point of the LKB came in 1992 when the reputed Puri group took substantial stake in the equity of the bank.

Now the LKB is a pan-Indian Bank with network of 112 branches spread across 11 States and is poised to have 114 branches across 13 States / Union Territories at the earliest.98 Net worth of the bank, which was Rs.106.12 crores as of 31.03.2005, has gone up to Rs.163.81 crores as of 31.03.2006.

In 2006, the boards of directors of Centurion Bank of Punjab Limited and Lord Krishna Bank Limited approved the merger of Lord Krishna Bank with Centurion Bank of Punjab. New generation private sector Centurion Bank of Punjab was formed with the merger of Centurion Bank and Bank of Punjab in 2005.

The independent valuers appointed jointly by both banks to determine the swap ratio for the merger, Deloitte Haskins & Sells and N M Raiji & Co have worked out the share swap ratio, which has been fixed at 5:7, i.e., for every five shares of Lord Krishna Bank, its shareholders will receive seven shares of Centurion Bank of Punjab.

Due to this takeover, this bank is now beyond the purview of my study.

2.33.6 The Nedungadi Bank Limited

The Nedungadi Bank Limited, the oldest private sector bank in Kerala, was established in the year 1899 by Rao Bahadur T.M. Appu Nedungadi, the author of the first Malayalam novel, Kundalatha. Nedungadi bank was incorporated in 1913, and in 1965 had acquired selected assets and deposits of the Coimbatore National Bank.
In the year 2002, The Reserve Bank of India unveiled to public a draft scheme to merge the Kerala-based Nedungadi Bank with Punjab National Bank (PNB). The scheme was available to the public from both the banks. The scheme of amalgamation offered full protection of all public deposits in the old private sector bank.\footnote{Bilgrami S.A.R. \textit{Growth of Private Sector Banks- A Regional Growth Analysis} (New Delhi: Deep & Deep, 2005) 158-163.}

All the employees of Nedungadi Bank became the employees of PNB at the same remuneration and terms and conditions. From the date of operation of the scheme, the entire paid-up capital and reserves of the bank was treated as provision for bad and doubtful debts and depreciation. According to the scheme, all assets, liabilities, powers, claims and demands were transferred to PNB. The books of Nedungadi were closed, balanced and the balance sheet prepared as at November 2, 2002.

The Punjab National Bank took over the Nedungadi Bank Limited (NBL), with all its 174 branches working as PNB branches in the year 2003.

Due to this takeover this bank is now beyond the purview of my study.
2.34 The Banks at a glance

The following table shows a bird’s eye view of the four banks under study (Table-T 1).

**Table T 1: The Banks at a Glance**

<table>
<thead>
<tr>
<th></th>
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</thead>
<tbody>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Branches</td>
<td>363</td>
<td>181</td>
<td>603</td>
<td>548</td>
</tr>
<tr>
<td>ATMs</td>
<td>123</td>
<td>75</td>
<td>666</td>
<td>308</td>
</tr>
<tr>
<td><strong>Assets</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>As at 31.03.07</td>
<td>53006272</td>
<td>34479452</td>
<td>250899325</td>
<td>136525790</td>
</tr>
<tr>
<td>(Rs 000s omitted)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Advances</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>As at 31.03.07</td>
<td>30126416</td>
<td>18394961</td>
<td>148991002</td>
<td>79189121</td>
</tr>
<tr>
<td>(Rs 000s omitted)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Capital</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>As at 31.03.07</td>
<td>107652</td>
<td>320578</td>
<td>856033</td>
<td>704052</td>
</tr>
<tr>
<td>(Rs 000s omitted)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Long Term Debt</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>As at 31.03.07</td>
<td>33835640</td>
<td>22170285</td>
<td>169083723</td>
<td>93420101</td>
</tr>
<tr>
<td>(Rs 000s omitted)</td>
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</tbody>
</table>